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ARTICLES

The Broad Spectrum of Trade Secret Damages

By Glenn Perdue – April 18, 2012

Compensatory damages for the infringement of intellectual property (IP) may be based on the actual damage suffered by a claimant, a reasonable royalty, the unjust enrichment of an infringer, or some form of statutory damage, depending on the type of IP being infringed. For instance, damages for the infringement of a utility patent are based on the claimant's actual damages (typically measured as lost profits) or a reasonable royalty. However, in cases of trade secret misappropriation, all forms of IP damage remedies may be available, other than statutory damages, which are only available under certain circumstances in trademark and copyright infringement matters.

Unlike patents, trademarks, and copyrights, which are disclosed and substantially governed by federal law, trade secrets are governed by state law and rely on some level of nondisclosure to maintain their status as a trade secret. Indeed, the economic value of a trade secret stems partially from its secrecy. Generally speaking, a trade secret provides economic value to its owner by providing some sort of proprietary competitive advantage.

The Uniform Trade Secrets Act

According to the Uniform Law Commission, the Uniform Trade Secrets Act (UTSA) has been enacted by 45 states, Puerto Rico, and the Virgin Islands, and adoption legislation is pending in Massachusetts and New Jersey. That leaves New York, Texas, and North Carolina as the only states that had not enacted—or were not actively attempting to enact—the UTSA at the time of this writing. Uniform Law Commission, [Trade Secrets Act](#) (accessed Dec. 16, 2011). However, even in states that have not enacted the UTSA, existing laws may, in many ways, be similar to the UTSA with respect to defining a trade secret and with respect to damage provisions. See, for instance, the North Carolina Trade Secrets Protection Act, which provides for “actual damages” or “unjust enrichment.” For these reasons, the following discussion will be based primarily on the UTSA (as amended in 1985).

Section 1 of the UTSA defines a trade secret as follows:

[I]nformation, including a formula, pattern, compilation, program, device, method, technique, or process, that:

- (i) derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use, and
- (ii) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.



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This definition illustrates the linkages between secrecy and economic value that must be present for a trade secret to exist.

Section 2 of the UTSA addresses the issue of injunctive relief. Subsection 2(b) states:

[A]n injunction may condition future use upon payment of a *reasonable royalty* for no longer than the period of time for which use could have been prohibited.

UTSA § 2(b) (emphasis added).

Section 3 of the UTSA addresses the issue of damages. Subsection 3(a) states:

Damages can include both the *actual loss* caused by misappropriation and the *unjust enrichment* caused by misappropriation that is not taken into account in computing actual loss. In lieu of damages measured by any other methods, the damages caused by misappropriation may be measured by imposition of liability for a *reasonable royalty* for a misappropriator's unauthorized disclosure or use of a trade secret.

UTSA § 3(a) (emphasis added).

Trade secret damage recoveries based on actual loss, unjust enrichment, or a reasonable royalty are limited to the period of time during which trade secret status is deemed effective. The comments following section 3 describe that period of time as follows:

Like injunctive relief, a monetary recovery for trade secret misappropriation is appropriate only for the period in which information is entitled to protection as a trade secret, plus the additional period, if any, in which a misappropriator retains an advantage over good faith competitors because of misappropriation. Actual damage to a complainant and unjust benefit to a misappropriator are caused by misappropriation during this time alone. A claim for actual damages and net profits can be combined with a claim for injunctive relief, but, if both claims are granted, the injunctive relief ordinarily will preclude a monetary award for a period in which the injunction is effective.

UTSA § 3 cmt. (citations omitted).

Actual Loss

Consistent with the concept of recovering an “actual loss,” an injured party may seek its lost profits due to the misappropriation of its trade secrets. It makes economic sense that this method of recovery is available because it is conceptually straightforward and often the most apparent means of making an injured party whole.

Damage theory related to lost profits is highly evolved in the United States, particularly in the area of IP damages. Lost profits are typically based upon the plaintiff's lost “net profits” or “incremental profits” as generally measured at the operating profit level. If lost profits resulted from lost revenues, incremental costs related to these revenues are deducted. These are generally



costs that would have been incurred if the lost revenues had been realized by the plaintiff. Put another way, these are the “costs saved” by the plaintiff as a result of *not* generating the lost revenues. While the philosophical basis of lost profits may be straightforward, the legal and economic concepts to be considered in calculating lost profits can be esoteric and complex.

A plaintiff may experience actual damages due to lost revenues, increased costs, or both, resulting from a defendant’s misappropriation. Lost revenues may result from lost sales of the protected product or service, lost sales of complementary products and services (convoyed sales), and price erosion resulting from the misappropriator’s entry into the market with a competitive good or service.

While prominent, lost profits are not the only measure of actual loss a plaintiff may use to calculate trade secret damages. Courts have accepted calculations of actual loss based on the investment value of the trade secret and the loss of business value resulting from the misappropriation. *See, e.g., Cardiovention, Inc. v. Medtronic, Inc.*, 483 F. Supp. 2d 830, 846 (D. Minn. 2007).

Of course, whether an actual loss is being claimed due to the misappropriation of a trade secret or some other wrongful conduct, a plaintiff must still show how the damages being claimed were caused by the wrongful conduct. Recovery will not be successful unless this linkage is sufficiently demonstrated. *See Robert L. Dunn, Recovery of Damages for Lost Profits* § 1.1 (6th ed.) (The Proximate Cause Rule).

Unjust Enrichment

Under the premise that a defendant was unjustly enriched due to misappropriation, a plaintiff may seek the defendant’s wrongfully gained net profits as a remedy to the extent that such profits do not result from sales considered in the calculation of the actual loss. With sufficient support, wrongfully gained sales can also include sales of related products and services (convoyed sales).

Under federal statute, when the defendant’s profits are being sought as damages in trademark and copyright infringement matters, the plaintiff is responsible for identifying revenues only, while the defendant is responsible for identifying deductions for costs and factors unrelated to the infringement. *See* 15 U.S.C. § 1117(a)(3) for trademark damages and 17 U.S.C. § 504(b) for copyright damages. While there is no such provision for the splitting of these calculation duties under the UTSA, certain courts have endorsed this type of approach. For instance, citing the federal Copyright Act, a Massachusetts appeals court provided the following guidance in a case in which the defendant’s unjust gains were the sole source of damages being sought by the plaintiff:

Once a plaintiff demonstrates that a defendant made a profit from the sale of products produced by improper use of a trade secret, the burden shifts to the defendant to demonstrate those costs properly to be offset against its profit and the portion of its profit attributable to factors other than the trade secret.



USM Corp. v. Marson Fastener Corp., 392 Mass. 334 (Mass. App. Ct. 1984).

Speaking further to the basis for seeking a defendant’s profits as an appropriate measure of trade secret damages, this opinion states, “The guiding principle is to order the wrongdoing defendant to give up all gain attributable to the misuse of the trade secret and to measure that gain as accurately as possible.”

As discussed in the previous section, lost “incremental” operating profits—as derived after the deduction of incremental costs—are a broadly accepted measure of lost profits in calculating the plaintiff’s actual loss. However, when calculating the defendant’s gained profits, there is less consensus about the means by which deductible costs should be determined. Generally speaking, for purposes of calculating a defendant’s profits, deductible costs may be based on one of the following:

Incremental Costs. Variable costs are incremental, but certain semi-variable or “step” costs may also be incremental depending on volume levels.

Direct Assistance Costs. This view of costs generally considers variable costs and overhead costs related directly to the product, product group, or business unit relevant to the analysis. Direct overhead costs may be deducted using an allocation method based on accused revenues, units, or some other measure.

Fully Allocated Costs. This approach considers costs on a fully allocated or “fully absorbed” basis. Therefore, in addition to the variable and direct overhead expenses considered under direct assistance costs, this approach may also consider indirect overhead, such as corporate office expenses, also on an allocated basis.

To summarize, variable costs, semi-variable costs, direct overhead, and indirect overhead may all be relevant cost considerations in determining the defendant’s profits as a measure of its unjust enrichment.

However, the defendant’s gained profits may not be the only measure of its ill-gotten gains. The economic value of trade secrets to the misappropriator at the time of misappropriation could also be an appropriate measure of the defendant’s unjust enrichment. This concept is discussed more fully in the following section.

Reasonable Royalty

A reasonable royalty represents compensation for the use of IP that a willing licensor and willing licensee would have negotiated in an arm’s-length setting prior to infringement or misappropriation. A plaintiff can opt to be compensated for misappropriation by imposition of a reasonable royalty “in lieu of damages measured by any other methods,” as stated in subsection 3(a) of the UTSA.



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In one regard, a reasonable royalty represents a form of actual loss to a plaintiff (licensor) under the premise that, had the misappropriator (licensee) negotiated a license instead of misappropriating, the plaintiff would have generated additional revenues and profits from the license. In another regard, a reasonable royalty represents the component of economic value wrongfully obtained by the misappropriator, thus also representing a form of unjust enrichment. The Fifth Circuit echoed this sentiment in discussing the determination of trade secret damages in *University Computing Co. v. Lykes-Youngstown Corp.*:

Because the primary concern in most cases is to measure the value to the defendant of what he actually obtained from the plaintiff, the proper measure is to calculate what the parties would have agreed to as a fair price for licensing the defendant to put the trade secret to the use the defendant intended at the time the misappropriation took place.

504 F.2d 518 (5th Cir. 1974).

In this 1974 opinion, the Fifth Circuit delineated a list of factors it considered relevant in the assessment of a reasonable royalty:

In calculating what a fair licensing price would have been had the parties agreed, the trier of fact should consider such factors as the resulting and foreseeable changes in the parties' competitive posture; the prices past purchasers or licensees may have paid; the total value of the secret to the plaintiff, including the plaintiff's development costs and the importance of the secret to the plaintiff's business; the nature and extent of the use the defendant intended for the secret; and finally whatever other unique factors in the particular case which might have affected the parties' agreement, such as the ready availability of alternative processes.

Of course, in its 1971 opinion, the court in *Georgia-Pacific* delineated its list of 15 factors that remain core considerations to the determination of a reasonable royalty in patent (and non-patent) cases today. See *Georgia-Pacific Corp., v. United States Plywood Corp.*, 318 F. Supp. 1116 (S.D.N.Y. 1970) aff'd, 446 F.2d 225 (1971). In fact, the [Iyer](#) and [Hansen articles](#) discuss the CAFC's recent *Uniloc* decision, which spoke directly to the proper interpretation and use of certain *Georgia-Pacific* factors.

Other Damage Provisions

Under subsection 3(b) of the UTSA, exemplary damages of up to two times the amount of compensatory damages awarded under subsection 3(a) may be awarded "if willful and malicious misappropriation exists." In addition, the court may award reasonable attorney fees to a prevailing party under section 4 of the UTSA, based on certain conditions.

Case Examples

By their nature, trade secrets often relate to methods of production, software, and proprietary customer information.



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USM Corp. v. Marson Fastener Corp., 392 Mass. 334 (Mass. App. Ct. 1984), was a 1984 Massachusetts trade secrets case involving methods and systems for manufacturing “blind rivets” that were misappropriated by Marson from USM, the trade secret owner. While the production improvement provided by the USM trade secret was characterized by Marson as “minor,” the court found as follows:

The fact that use of the trade secret was the sole reason for the defendants’ profitability makes it appropriate to measure USM’s recovery by consideration of the defendants’ profits from the manufacture and sale of blind rivets and inappropriate to consider only the value, or cost saving, to the defendants arising from the use of the trade secret.

The court thus articulated the causal relationship that it found between the defendant’s use of the trade secret and resulting profits from the sale of blind rivets as its basis for concluding that Marson was unjustly enriched by the amount of these profits. The court found deductions for incremental costs used in the calculation of Marson’s profits to be acceptable.

In the case of business software maintained as a trade secret, actual damages might be presented as the lost profits arising from lost sales that the trade secret owner would have captured but for the misappropriation. Or, as in *USM v. Marson*, the unjust profits earned by the misappropriator might be deemed an appropriate basis of recovery. However, a court might also determine that a “fair licensing price” is an appropriate remedy, as did the court in *University Computing Co. v. Lykes-Youngstown Corp.*, 504 F.2d 518 (5th Cir. 1974), which involved the misappropriation of COBOL-based computer source code for an inventory control system developed for retailers in the late 1960s.

When contemplating a reasonable royalty, the application of a running royalty to revenues or units sold may immediately come to mind. And in a setting where, for instance, the trade secret is a method of production that can be analogized to patented methods for which royalty rate information can be readily obtained, a running royalty might be appropriate and straightforward to apply. However, in *University Computing*, damages were ultimately based on a lump-sum royalty that was determined to be 2.5 times the cost incurred by the trade secret owner to produce the system.

Finally, a case that provides an example of trade secret damages arising from the misappropriation of proprietary customer information is *Hamilton-Ryker v. Keymon*, 2010 WL 323057 (Tenn. Ct. App. Jan. 28, 2010), a recent Tennessee Court of Appeals case. After being laid off, Tammy Keymon began competing with her previous employer by working directly for Verizon Communications, Inc., the client she previously served while at Hamilton-Ryker, providing shipping-related services for telephone directories produced for Verizon. While still employed by Hamilton-Ryker, Keymon calculated that the Verizon projects generated an average net profit of 32.9 percent.



Prior to her layoff, Keymon solidified her direct contracting arrangement with Hamilton-Ryker's client. She then emailed 56 documents from her Hamilton-Ryker email account to her personal email account. These documents were determined to be trade secrets of Hamilton-Ryker and were ultimately used in Keymon's direct contracting work on the Verizon account. The emailed information included Verizon production schedules, Verizon project profit and loss analysis, Verizon mail address listings in a label-ready format, and Hamilton-Ryker invoices related to the Verizon projects.

The case reached the trial court in March 2008. By that time, Keymon had billed approximately \$1.45 million to her former employer's client. Hamilton-Ryker applied the 32.9 percent profitability rate to these billings in arriving at an actual damage amount of \$477,178 which was doubled by the trial court as exemplary damages. This damage award was upheld on appeal.

Unique Facts and Circumstances

In *University Computing*, the Fifth Circuit provided the following insight regarding trade secret damages:

Our review of the case law leads us to the conclusion that every case requires a flexible and imaginative approach to the problem of damages. We agree with the Court of Appeals for the Sixth Circuit that "each case is controlled by its own peculiar facts and circumstances," and accordingly we believe that the cases reveal that most courts adjust the measure of damages to accord with the commercial setting of the injury, the likely future consequences of the misappropriation, and the nature and extent of the use the defendant put the trade secret to after misappropriation.

504 F.2d 518 (5th Cir. 1974) (citations omitted).

The broad spectrum of economic facts and circumstances encountered in trade secret cases leads to the need for flexibility in the calculation of damages. Fortunately, state legislatures and courts have responded to this need by supporting a similarly broad spectrum of damage approaches for use by plaintiffs and their experts in the calculation of trade secret damages.

Keywords: litigation, intellectual property, trade secret damages, Uniform Trade Secrets Act, damages provisions

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Patent Damages in the Wake of *Uniloc v. Microsoft*

By Shankar Iyer – April 18, 2012

The world of patent damages is in a state of flux. We know that the Federal Circuit now calls for a greater degree of specificity and rigor in presenting or rebutting claims for patent infringement damages. But while old “rules” are dead and buried, no worthy successors have yet found their assured place in the sun. In the wake of *Uniloc USA, Inc. v. Microsoft Corp.*, 632 F.3d 1292 (Fed. Cir. 2011), navigating hitherto uncharted waters of the new damages regime has been fraught with uncertainty.

Rate and Base, Done Right

There is heightened scrutiny of the reasonable royalty and its nexus with the contribution of the patented invention to the claimed royalty base. And rightly so. Conceptually, as a matter of economics, the royalty rate and the royalty base are not independent variables. This is because any royalty rate that is the outcome of a hypothetical negotiation is necessarily a function of the patentee’s profit stream, which is itself a function of the patentee’s relevant revenue (the “royalty base”). Therefore, damages approaches in which royalty rates (from comparable license agreements, industry data, or other sources) are unlinked from the revenue bases in question are likely to run into trouble. And indeed they have. Linking the royalty rate to the proper base is precisely the motivation behind Judge Rader’s decision in *Cornell University v. Hewlett-Packard Co.*, 609 F. Supp. 2d 279 (N.D.N.Y. 2009). In *Cornell*, Judge Rader identified the processor’s revenue as the royalty base because the patented technology was “a small part of the IRB, which is a part of a processor, which is part of a CPU module, which is part of a ‘brick,’ which is itself only part of the larger server.” *Id.* at 283.

Some economists have argued that the choice of the royalty base should be largely irrelevant as long as the royalty rate is conditioned on the choice of royalty base so that it reflects the economic value of the patented technology. To support their contention, they have pointed to the decision in *Lucent Technologies, Inc. v. Gateway, Inc.*, which stated:

There is nothing inherently wrong with using the market value of the entire product [as the royalty base], especially when there is no established market value for the infringing component or feature, so long as the multiplier [i.e., the royalty rate] accounts for the proportion of the base represented by the infringing component or feature.

580 F.3d 1301 (Fed. Cir. 2009).

However, positing a “low enough” royalty rate (to account for the relative contribution of the patented invention) is no longer permissible, and the *Uniloc* case was quite clear on this point: “The Supreme Court and this court’s precedents do not allow consideration of the entire market value of accused products for minor patent improvements simply by asserting a low enough royalty rate.” 632 F.3d at 1320.

Application of a Strict Standard

Several post-*Uniloc* courts appear to have applied a strict standard vis-à-vis entitlement to the entire market value (EMV). In *Lucent v. Gateway*, the infringement allegations were related to a certain feature in Microsoft’s Outlook program. The jury awarded Lucent a lump-sum award of \$358 million that was later vacated by the Federal Circuit. 580 F.3d at 1336. In the second trial, Lucent introduced a modified damages calculation that first identified the percentage of Outlook customers who use the patented feature and then limited the revenue base to Outlook revenue stemming from these customers. The district court rejected this approach, stating that “Lucent fail[ed] to properly apportion its damages calculation to separate between patented features and unpatented features of Microsoft Outlook,” and ordered Lucent to either perform additional apportionment or justify its use of the EMV. In its supplemental report, Lucent introduced a per-unit calculation based on the whole unit price of Outlook and argued that this is consistent with Microsoft’s own license practices. The district court decided that while such Microsoft licenses may be relevant to the factors identified in *Georgia-Pacific Corp. v. U.S. Plywood Corp.*, 318 F. Supp. 1116 (S.D.N.Y. 1970), *aff’d*, 446 F.2d 295 (2d Cir. 1971), an approach based on the whole unit price still failed to account for other unpatented features and that Lucent needed to further apportion its damages calculations.

In *Versata Software v. SAP America*, No. 2:07-CV-153, 2011 U.S. Dist. LEXIS 102333 (E.D. Tex. Sept. 9, 2011), the district court excluded the reasonable royalty analysis of all three of the plaintiff’s experts because their analysis relied on “speculation and guesswork, and was divorced from the factual and economic realities of the case.” The district court stated that while the plaintiff’s experts did not apply an explicitly stated royalty rate to the EMV of the accused products, the plaintiff’s experts “attempted to play mathematical games,” and in the end, their methodology amounted to applying “an unsupported percentage to SAP’s total revenue in violation of Federal Circuit precedent regarding EMV.” *Inventio AG v. Otis Elevator*, No. 06-CV-5377, 2011 U.S. Dist. LEXIS 88965 (S.D.N.Y. June 22, 2011), is another example in which, despite evidence that the feature was a “substantial basis for demand” for the infringing product and that its absence would put a competitor at a disadvantage, the court struck any entitlement to damages based on the EMV:

It is not enough to present evidence that the patented feature was desirable, or that it played some role—even a substantial role—in the customer’s decision to purchase a system containing the infringing product. If the patented aspect of a system containing both patented and unpatented elements creates a “substantial basis for demand,” that would tend to support the reasonableness of a higher royalty rate. But as long as other features of a product contributed to the customer’s decision, Supreme Court precedent (which the Federal Circuit is powerless to overrule) demands that there be an apportionment of the defendant’s profits and patentee’s damages between the patented features and the various unpatented features of the “whole machine.”

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Not all courts have adopted a strict standard, though. The court in *Mondis Technology Ltd. v. LG Electronics Inc.*, No. 2:07-CV-565, 2011 U.S. Dist. LEXIS 78482 (E.D. Tex. June 14, 2011), adopted what may be called a “non-absolutist” approach to the *Uniloc* court’s directive. In *Mondis*, the district court reasoned that the *Uniloc v. Microsoft* “basis for customer demand” test could not be “absolute.” If it were, on these facts, the patentee would be between Scylla and Charybdis: Ignore the licenses of the patents-in-suit, even though they may constitute “the most reliable evidence” from which to calculate a royalty or try to recast the licenses by inferring the relative contribution of the patented feature in those licensed products, making the “previously comparable licenses non-comparable.” However, using the infringer’s licensing history to untether the proscription on EMV damages under *Uniloc*, and thereby render it permissible, has not found favor in other courts.

Successful EMV Approaches

Courts have allowed an EMV damages analysis to go to a jury when evidence shows that the patented feature “substantially creates the value” of the accused product. In *Funai Electric Co. v. Daewoo Electronics Corp.*, the plaintiff employed what may be called a funnel approach that passed muster with the Federal Circuit vis-à-vis entitlement to EMV damages. First, and at the broadest level, Funai’s expert presented evidence that there was general industry demand for smaller, faster, more reliable videocassette records. Second, specific evidence was provided that Funai’s patented technology satisfied consumer demand for these requirements and that there were no available, noninfringing substitutes. Third, Funai was able to satisfy the Federal Circuit that its technology was the basis for consumer demand. Such a funnel approach is attractive but works only if the evidence at the narrowest point of the funnel actually meets the “patented technology creates the value” requirement. In *ActiveVideo Networks, Inc. v. Verizon Communications*, No. 2:10-CV-248, 2011 U.S. Dist. LEXIS 91722 (E.D. Va. July 29, 2011), the district court refused to exclude damages testimony based on the EMV, finding that the plaintiff had presented substantial evidence that the patented feature is “the basis for consumer demand for [the infringing system] or substantially contributed to the value of the system.”

ActiveVideo is an interesting decision because there may be an underlying tension between “the basis for demand” and “substantially contributed to the value” prongs of the test used by the district court there. The former prong is closer in spirit to the “substantially creates the value” principle; the economic notion that the value of the accused product is a number close to zero absent the patented invention is implicit; whereas, implicit in the latter prong is the relevance of other factors that influence demand, something that the *Inventio* court used to strike the use of EMV damages.

Damages Approaches after *Uniloc*

Despite variation in how the courts are applying the Federal Circuit’s EMV damages precedents, some tea leaves may be cautiously read: The *Uniloc* standard is not insurmountable; proving that the patented feature is the basis for consumer demand probably means being closer to “substantially creates” than “substantially contributes”; the more complex and multifaceted a

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product, the less likely that an economic justification of “substantially creates” will carry the day; the infringer’s licensing history is unlikely to be a free pass to an EMV damages entitlement, even in an evidence-poor environment; and there is increased demand from the courts for the real-world data that can readily be found through survey evidence.

Interestingly, some recent damages approaches have departed completely from base and rate determinations and undertaken reasonable royalty analysis under the aegis of bargaining theory. Such approaches essentially circumvent the issue of apportioning the royalty base by using a profit-splitting approach. Such profit-splitting approaches have ranged from being predicated on very well established economics principles, such as Nash bargaining theory, to ipse dixit determinations based on implicit rules of thumb. In the case of Nash bargaining theory, while the economic concept is sound enough to have garnered its originator a Nobel Prize in economics, anchoring the approach to “a record of actual transactions” in the patent damages context has been problematic. Indeed, the logic of the court in *Oracle v. Google*, No. 3:10-CV-03561, 2011 U.S. Dist. LEXIS 80280 (N.D. Cal. July 22, 2011), is precisely that “the Nash solution cannot describe real-world behavior unless the conditions on which it is premised are satisfied in the real world.”

Some commentators have questioned the use of profit splitting by asking whether the approach is justified in the first place. According to this school of thought, the difficulty in apportioning between the fraction of profits attributable to the patent holder’s invention and the remainder attributable to the infringer’s own contributions (at least in part) led Congress to eliminate the infringer’s profits as a remedy for utility patent infringement in 1946. M. Gooding et al., “Reasonable Royalty Patent Infringement Damages after *Lucent v. Gateway* and *Uniloc v. Microsoft*: Reports of the Dearth of Patent Infringement Damages Are Greatly Exaggerated,” 83 *Pat., Trademark & Copyright J.* 235 (BNA) (Dec. 16, 2011). Therefore, a profit-splitting approach turns the clock back, as it were, in these commentators’ minds; instead, they posit that the proper place to start for a damages expert is a royalty rate and base calculation with the base being apportioned (“rate/base with apportionment”) instead of a “naked” profit-splitting approach. Of course, the rate/base with apportionment approach has its own critics, and some have expressed the view that “the apportionment approach of reducing the royalty base treats the symptom (an overly large damages award), without addressing the underlying cause.” E. Bailey et al., “Making Sense of ‘Apportionment’ in Patent Damages,” 12 *Colum. Sci. & Tech. L. Rev.* 255 (June 2, 2011). In their view, the underlying cause of excessive damages calculations is the approach sometimes taken by damages experts of choosing the royalty rate and royalty base independently of each other and without reference to the economic value of the patented technology.

Nevertheless, there are practical issues surrounding a profit-splitting approach if it is to be done correctly. When so-called synergies are present between the patented invention and other features (something that critics of the “rate base with apportionment” approach point to), how does a profit-splitting approach reflect the incremental value of the patented technology to the

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infringer as compared with the next best alternative? To grapple with this *in practical terms*, and create a methodology that does not substantively reduce to an unsupported rule-of-thumb approach, is a challenge that is likely to be played out in the courts with varying degrees of success.

On the other hand, market-based evidence—such as statistical or regression analysis, customer surveys, customer interviews, and “marketplace-wide evidence of demand sensitivities”—has been unambiguously sought by the courts. How successfully experts implement market-based approaches, however, will be a function of context as well as the availability of data. A relatively inexpensive customer interview approach in a “simple” product market will not work for a complex, high-tech product for which demand depends on a multiplicity of product attributes, some more important than others. Thus, the use of economists who study consumer demand and marketing experts is likely to grow to calculate patent damages. Surveys—as an affirmative club or as a defensive shield—also are likely to become more important in calculating patent damages. By definition, surveys are market-based evidence; therefore, they can be a powerful tool that is responsive to context-specific treatment that many courts are demanding.

A recent example of a survey-based evidence informing damages calculations is *Lucent Technologies, Inc. v. Microsoft Corp.*, No. 07-CV-2000, ECF No. 1478, at 14–19 (S.D. Cal. Nov. 10, 2011). The Lucent survey approach was roughly based on the following scheme: A set of respondents is surveyed, and the critical question is something like, “If the product did not have feature X, would you still buy the product?” (the assumption being that the patented technology maps onto feature X); a subset of respondents, say Y percent, reveal that they would not buy the product absent the feature X; the patentee then argues that the infringer would have conducted the hypothetical negotiation knowing that if it did not license the patent, it would lose some portion of its revenue, which is a function of Y percent; and the damages base is adjusted accordingly. This approach has the virtue of simplicity and straightforward interpretation. Interestingly though, the *Lucent* court, while allowing the survey into evidence, implicitly recognized that the “must have” feature (X) may have been one of several “must have” features, even for the small percentage of respondents who would not buy the product without the “must have” feature.

There are, of course, many other approaches to surveys that can capture awareness, incidence of usage, or the relative importance of a feature in a multifeature product. In the latter case, eliciting responses from survey respondents can accurately capture to what extent the feature or features implicated by the patented technology are (or are not) important drivers of demand. However, in all but the simplest of surveys, there may be challenges in properly selecting the population to survey and accurately representing the claim or claims of the patent to the respondents *in language that the respondents will understand*. Notwithstanding these challenges, surveys, when conducted properly and interpreted correctly, are likely to become increasingly important in aiding the fact finder.

Treating Comparable Licenses

In the wake of *Lucent v. Gateway*, a patentee that wishes to rely on other license agreements to support its reasonable royalty damages claim has a clear obligation to ensure it can prove that “the licenses relied on . . . in proving damages are sufficiently comparable to the hypothetical license at issue in suit.” 580 F.3d.

Comparability between the hypothetical negotiation of a reasonable royalty for the patent at issue and prior licensing agreements must be supported by evidence more detailed than simply being concerned with the same general industry or type of product. The licenses must be comparable economically or technologically, and where a patentee attempts to introduce licenses that are less closely linked economically or technologically to the facts at issue in a case, any differences must be carefully explained by the evidence before a court will allow their use in a reasonable royalty damages analysis. Absent such specific explanatory evidence, the most that the looser, more general license comparisons can be used for is to introduce evidence regarding the general *structure* of such license agreements, such as a preference for lump-sum royalties as opposed to running royalties.

In *ResQNet.com Inc. v. Lansa Inc.*, 594 F.3d 860 (Fed. Cir. 2010), the Federal Circuit seemed more open to the use of settlement licenses in the calculation of hypothetical negotiation royalties, *in the absence of alternative comparable licenses*. In *ResQNet*, the Federal Circuit set aside a \$12.5 million reasonable royalty verdict, criticizing the patentee’s damages expert for using licenses “with no relationship to the claimed invention” in order to “drive the royalty rate up to unjustified double-digit levels.” Five of the seven licenses relied on by the patentee had no relation to the claimed invention; they were re-branding or re-bundling licenses that included software products and source code as well as marketing, training, maintenance, and upgrade support, in exchange for ongoing revenue-based royalties. “Notably, none of these licenses even mentioned the patents in suit or showed any other discernible link to the claimed technology.” *Id.* The two other licenses arose out of litigation over the patents in suit and were also flawed bases for a reasonable royalty analysis: One was a lump-sum agreement (which the patentee’s expert could not even translate into a royalty rate), and the other called for a royalty rate substantially less than the 12.5 percent the expert was proposing. Significantly, however, the Federal Circuit remanded the case back to the trial court for reconsideration of the reasonable royalty calculation, observing that “the most reliable license in this record arose out of litigation” and noting that “the district court may also consider the panoply of ‘events and facts that occurred thereafter and that could not have been known to or predicted by the hypothesized negotiators.’” Thus, *ResQNet* appeared to open the door for potential use of settlement licenses in calculating royalty damages.

Subsequently, however, in *Wordtech Systems Inc. v. Integrated Networks Solutions, Inc.*, 609 F.3d 1308 (Fed. Cir. 2010), the Federal Circuit noted that several of the licenses used in a reasonable royalty calculation were signed “after initiating or threatening litigation against the licensees,” and the court reiterated that “litigation itself can skew the results of the hypothetical



negotiation.” In *Wordtech*, the Federal Circuit held that of the 13 licenses relied on by the patentee at trial, none was sufficient to support the verdict. The Federal Circuit also found that past royalty rates of 3 to 12 percent could not explain the jury’s rate of 26.3 percent. The Federal Circuit therefore found that the damages awarded by the jury were “clearly not supported by the evidence” and “based only on speculation or guesswork.”

There is no uniform approach by the courts regarding whether litigation licenses may be used to calculate a reasonable royalty rate. Some courts have admitted litigation settlement agreements into evidence, while others have ruled such agreements inadmissible. Or, where the agreements are ruled admissible, they are also deemed to have minimal probative value on the reasonable royalty question. Courts have declared that the admissibility of such agreements must be determined on case by case and have criticized the selective use of a subset of litigation settlement agreements favorable to the claimant’s analysis.

Given this variance, at some point, the Federal Circuit will undoubtedly provide additional direction on the issue of litigation licenses. In the interim, patentees who wish to use litigation licenses to calculate royalty rates should be prepared to demonstrate specific facts supporting the claim of comparability between those litigation licenses and the license at issue. Therefore, in a climate where there is, and correctly so, heightened scrutiny of licensing terms and comparability between licenses, licensing experts who have real-world licensing experience are likely to become increasingly important.

Conclusion

Notwithstanding several landmark decisions in the past few years, significant gray areas remain in the calculation of reasonable royalty patent damages. Damages experts will need to look to the Federal Circuit for clarity before they can adopt a stable set of heuristics for doing patent damages “correctly.” In a real sense then (and borrowing from Charles Dickens), “we have everything before us, we have nothing before us.”

Keywords: litigation, intellectual property, patent damages, entire market value, licenses

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Showing a Disgorgement of Profits under the Lanham Act

By Oliver Alan Ruiz – April 18, 2012

The 1999 amendments to the Lanham Act, 15 U.S.C. § 1051 et seq., and, in particular, the revision to section 1117(a) of the act, have spurred dissension among federal circuit courts regarding the evidentiary showing necessary to support a disgorgement of lost profits as an equitable remedy under the revised statute.

Some circuits continue to require evidence of willful infringement as a prerequisite to an award of profits, while other circuits have decided that willfulness is only a factor to be considered in connection with the propriety of an award of a defendant's profits under the Lanham Act, pointing to the plain language of the revised statute.

Generally, prior to the 1999 amendments to the Lanham Act, federal courts employed a bright-line rule and required evidence of willful infringement to justify the equitable remedy of a disgorgement of profits under the statute. However, with the revision of the statute, and specifically, the inclusion of the word "willful" only with respect to claims under section 43(c) (concerning trademark dilution), some circuits have seized upon the plain language of the amended statute and have relegated the consideration of willful infringement to be only a factor to be considered when deciding on an award of profits under the statute.

As amended, the statute states, in pertinent part, as follows:

When a violation of any right of the registrant of a mark registered in the Patent and Trademark Office, a violation under section 43(a) or (d) [15 USCS § 1125(a) or (d)], *or a willful violation under section 43(c)* [15 USCS § 1125(c)], shall have been established in any civil action arising under this Act, the plaintiff shall be entitled, subject to the provisions of sections 29 and 32 [15 USCS §§ 1111, 1114], and subject to the principles of equity, to recover (1) defendant's profits, (2) any damages sustained by the plaintiff, and (3) the costs of the action.

15 U.S.C. § 1117(a) (emphasis added).

Despite the foregoing revision, some circuits have not read out of the statute the showing of willful infringement as a condition to an award of profits in claims involving infringement of registered marks, or violations of 43(a) or (d), as discussed below.

Circuits That Require a Showing of Willful Infringement as a Prerequisite

The majority view continues to be that the Lanham Act requires a showing of willfulness to support a disgorgement of a defendant's profits, but the number of circuits that require a showing of willfulness has diminished, with only the First, Second, Eighth, Ninth, Tenth, Eleventh, and D.C. Circuits continuing to require such a showing. Furthermore, in some circuits, which have not visited the specific issue since 1999, district courts have begun to call into question whether a



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departure from precedent is warranted. In addition, the First and Eleventh Circuits employ a disjunctive test that, while typically requiring a showing of willfulness, leaves room for awards of profits when unjust enrichment is proven.

Second Circuit

Prior to the 1999 amendment, the law of the Second Circuit required a plaintiff to prove that an infringer acted in bad faith (meaning intentional deception or willfulness) to recover an accounting of an infringer's profits. *See Int'l Star Class Yacht Racing Ass'n v. Tommy Hilfiger, U.S.A., Inc.*, 80 F.3d 749, 753 (2d Cir. 1996). The Second Circuit has not revisited the issue since the amendment, which has resulted in a split among the district courts, as recognized in a decision from the Southern District of New York:

In *Cartier v. Aaron Faber Inc.*, this Court held that, under a plain reading of the statute, the willfulness requirement did not survive the 1999 Amendment. . . . [S]ee also *Nike, Inc. v. Top Brand Co.* (holding that willfulness is not a prerequisite for an award of damages under § 1125(a)). However, other courts in this District have found that willful deception or bad faith continues to be a requirement to an award of profits or damages even after the 1999 Amendment. *See, e.g., GMA Accessories; Mr. Water Heater Enter., Inc. v. 1-800-Hot Water Heater, LLC; and Life Servs. Supplements, Inc. v. Natural Organics, Inc.*

Chanel, Inc. v. Veronique Idea Corp., 795 F. Supp. 2d 262, 268–69 (S.D.N.Y. 2011) (internal citations omitted).

Accordingly, it remains to be seen whether the Second Circuit will affirm its prior precedent and resolve the split among its district courts.

Eighth Circuit

The Eighth Circuit most recently dealt with this issue in January 2011. In *Masters v. UHS of Delaware, Inc.*, 631 F.3d 464 (8th Cir 2011), the court acknowledged the circuit split on the issue of whether “a Lanham Act plaintiff must prove willful infringement, rather than mere infringement, to be eligible for monetary damages under 15 U.S.C. § 1125(a),” but it assumed, without deciding, that willful infringement is a prerequisite of monetary relief. Perhaps tellingly, in its acknowledgement of the circuit split, the court cited to 5 J. McCarthy, *McCarthy on Trademarks and Unfair Competition* § 30:62 (4th ed. 2010), and noted that the treatise “criticiz[ed] circuit courts that have removed the willfulness requirement from § 1125(a) on the basis of the 1999 amendments. . . .” *Masters*, 631 F.3d at 472.

Ninth Circuit

The Ninth Circuit has historically required a showing of willful infringement as a prerequisite to recovery of an infringer's profits. *See Lindy Pen Co. v. Bic Pen Corp.*, 982 F.2d 1400, 1406 (9th Cir. 1993). This position was reaffirmed in an unpublished opinion subsequent to the 1999 amendment. *See Contessa Food Prods. v. Lockpur Fish Processing Co.*, 123 F. App'x 747, 751



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(9th Cir. 2005) (“[W]e deny Contessa’s request for disgorgement of profits because of an absence of any evidence supporting a reasonable inference that any of the Defendants willfully infringed its alleged trademark.”). However, a subsequent decision by a district court in the Ninth Circuit seemingly departed from this precedent and held that “[t]he plain language of [the 1999] amendment indicates that Congress intended to condition monetary awards for Section 43(c) violations on a finding of willfulness, but not Section 43(a) violations.” *R&R Partners, Inc. v. Tovar*, 2007 U.S. Dist. LEXIS 29819, *4–5 (D. Nev. Apr. 23, 2007).

Tenth Circuit

In *Western Diversified Services, Inc. v. Hyundai Motor America, Inc.*, 427 F.3d 1269 (10th Cir. 2005), the Tenth Circuit held that “to support an award of profits under the Lanham Act in the absence of actual damages, a plaintiff must ordinarily show that the defendant intended to benefit from the goodwill or reputation of the trademark holder.” *Id.* at 1274. But in *Western Diversified*, the court acknowledged a division of courts with respect to the *state of mind* that is necessary to show willful infringement, varying from deliberate and knowing to willful and fraudulent.

D.C. Circuit

To recover a defendant’s profits under the Lanham Act, the D.C. Circuit has ruled that a plaintiff must show the defendant acted willfully or in bad faith. *Foxtrap, Inc. v. Foxtrap, Inc.*, 671 F.2d 636, 641, 217 U.S. App. D.C. 130 (D.C. Cir. 1982). This issue has rarely been ruled upon in the D.C. Circuit, but the most recent post-1999 district court decision followed the *Foxtrap* rule, albeit in the context of a default judgment. *Breaking the Chain Found., Inc. v. Capitol Educ. Support, Inc.*, 625 F. Supp. 2d 1, 2 (D.D.C. 2009).

Circuits That Employ Disjunctive Tests for Awarding Profits

First Circuit

In a decision after the 1999 amendment of the Lanham Act, the First Circuit held that “when the rationale for an award of defendant’s profits is to deter some egregious conduct, willfulness is required.” *Tamko Roofing Prods., Inc. v. Ideal Roofing Co., Ltd.*, 282 F.3d 23, 36 (1st Cir. 2002). A subsequent district court decision acknowledged that “the evolving case law in this circuit is that a plaintiff must prove willfulness,” but recognized that the viability of such a holding had been “called into question” by the Third and Fifth Circuits. *Hipsaver Co. v. J.T. Posey Co.*, 497 F. Supp. 2d 96, 107 (D. Mass. 2007). Consequently, and despite the foregoing recognition, the First Circuit continues to require a showing of willfulness.

Eleventh Circuit

The Eleventh Circuit has held that an accounting of a defendant’s profits under the Lanham Act is appropriate where (1) the defendant’s conduct was willful and deliberate, (2) the defendant was unjustly enriched, or (3) it is necessary to deter future conduct. *See Howard Johnson Co., Inc. v. Khimani*, 892 F.2d 1512, 1521 (11th Cir. 1990). For the first and third factors, the Eleventh Circuit continues to require a showing of willfulness on the part of the defendant. *Optimum Techs., Inc. v. Home Depot U.S.A., Inc.*, 217 F. App’x 899, 902–3 (11th Cir. 2007). With regard to unjust enrichment, courts in the Eleventh Circuit will require evidence that

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infringers have “enriched themselves by tapping the reputation and good will of [the infringed].” *Id.*, quoting *Khimani*, 892 F.2d at 1521 n.9.

Circuits That Consider Willfulness as a Factor, and Not a Prerequisite

Third Circuit

Until 2005, precedent in the Third Circuit dictated that willful infringement was required in order to award an infringer’s profits. See *SecuraComm Consulting v. Securacom Inc.*, 166 F.3d 182 (3rd Cir. 1999). Upon revisiting the issue after the 1999 amendment, the Third Circuit “conclude[d] that *SecuraComm*’s bright-line willfulness requirement has been superseded by statute.” *Banjo Buddies, Inc. v. Renosky*, 399 F.3d 168, 174 (3d Cir. 2005). In its place, the Third Circuit adopted a factor-based approach previously elaborated in Fifth Circuit cases, which held that that an infringer’s intent was “an important—but not indispensable—factor in evaluating whether equity supports disgorging the infringer’s profits,” noting the following as some of the factors to be considered:

- (1) whether the defendant had the intent to confuse or deceive, (2) whether sales have been diverted, (3) the adequacy of other remedies, (4) any unreasonable delay by the plaintiff in asserting his rights, (5) the public interest in making the misconduct unprofitable, and (6) whether it is a case of palming off.

Id. at 175.

Fourth Circuit

In its 2006 decision in *Synergistic International, LLC v. Korman*, the Fourth Circuit aligned itself with the Third and Fifth Circuits and held that the determination of profit disgorgement damages is guided by the six factors identified by the Third Circuit in *Banjo Buddies*. In so doing, the Fourth Circuit pointed to the 1999 amendment as the basis for its rationale and stated that willfulness remained “a highly pertinent factor” in the analysis but that it was “not an essential prerequisite for a damages award.” *Id.* at 175 n.13.

Fifth Circuit

Unlike the other circuits, the Fifth Circuit had adopted the multi-factor analysis prior to the 1999 amendment of the Lanham Act, when determining whether an award of profits is appropriate in trademark infringement cases. See *Pebble Beach Co. v. Tour 18 Ltd.*, 155 F.3d 526 (5th Cir. 1998). The Fifth Circuit revisited the issue again on separate occasions, most notably in 2002, when it declined “to adopt a bright-line rule in which a showing of willful infringement is a prerequisite to an accounting of profits,” in light of its own precedent and the plain language of section 1117(a). *Quick Techs. v. Sage Group Plc*, 313 F.3d 338, 349 (5th Cir. 2002). However, like the Third and Fourth Circuits, the Fifth Circuit deemed willful infringement to be “an important factor which must be considered when determining whether an accounting of profits is appropriate.” *Id.*



Sixth Circuit

As noted in an unpublished opinion issued in 2006, in the Sixth Circuit, an award of profits may be warranted under various rationales, such as unjust enrichment, deterrence, and compensation. *Laukus v. Rio Brands, Inc.*, 391 F. App'x 416, 424 (6th Cir. 2010). That decision also affirmed that, although “a showing willfulness is not required, willfulness is one element that courts may consider in weighing the equities.” *Id.* Finally, the *Laukus* court decided that district courts in the Sixth Circuit should evaluate the six factors identified by the Fifth Circuit in *Quick Technologies*, when determining the propriety of a profits award under the Lanham Act.

Seventh Circuit

When faced with the issue of whether the Seventh Circuit requires a showing of willfulness in connection with a disgorgement of profits under the Lanham Act, a district court surveyed the law in the circuit and determined that the Seventh Circuit “considers willfulness or bad faith as a factor in deciding whether to award damages or profits, but it does not require such as a condition precedent to an award of damages based on disgorgement of profits.” *ISP.NET.LLC v. Qwest Commc'ns Int'l, Inc.*, 2004 U.S. Dist. LEXIS 20237, *11–12 (S.D. Ind. Sept. 24, 2004). In so doing, the district court acknowledged that this approach contrasts sharply with the bright-line employed by other circuits.

Conclusion

As shown above, the majority view continues to be that the Lanham Act requires a showing of willfulness to support a disgorgement of a defendant's profits, but the number of circuits that continue to require such a showing has diminished. Trademark litigators will no doubt continue to monitor decisions to assess, for example, whether the Second Circuit resolves its intra-circuit conflict and whether the United States Supreme Court visits (or perhaps, in the case of Congress, revisits) the impact of the 1999 Trademark Amendment.

Until then, one thing is clear: Willfulness will continue to be an important factor in determining whether an award of profits is appropriate in federal trademark infringement actions, either as a factor in the analysis or as a bright-line rule.

Keywords: litigation, intellectual property, disgorgement of profits, Lanham Act, willful infringement

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Willfulness under the America Invents Act

By Rick Sanchez – April 18, 2012

On September 16, 2012, section 298 of title 35, United States Code, regarding advice of counsel, will come into effect. This section codifies the premise asserted by the Federal Circuit in *In re Seagate Technology*, that the failure of an infringer to obtain the advice of counsel, or to present such advice to the court or jury, with respect to any allegedly infringed patent, may not be used to prove that the accused infringer willfully infringed the patent. In other words, courts are to exclude evidence of failure to obtain an opinion of counsel regarding infringement of an asserted patent to show willfulness. However, the provision omits any guidance for satisfying pleading requirements for willful infringement.

Willful Infringement

Willful infringement is built on the legal first principle that intentional disregard for the law justifies deterrence. “Damages have been defined to be the compensation which the law will award for an injury done, and are said to be exemplary and allowable in excess of the actual loss, where a tort is aggravated by evil motive, actual malice, deliberate violence or oppression.” *Scott v. Donald*, 165 U.S. 58, 86 (1897). Section 284 of title 35 of the United States Code provides a basis for this principle in patent law by stating that “[u]pon finding for the claimant the court . . . may increase the damages up to three times the amount found or assessed.”

Initially, the Federal Circuit established that a potential infringer, upon actual notice of another’s patent rights, owed the patent holder a duty of investigation as to whether a patent was infringed. *Underwater Devices Inc. v. Morrison-Knudson Co.*, 717 F.2d 1380, 1389–90 (Fed. Cir. 1983). This duty was typically evidenced by an opinion of counsel as to whether the potential infringer infringed the asserted patent. However, in *In re Seagate*, a unanimous en banc Federal Circuit panel struck down the duty of a potential infringer to investigate whether or not another’s patent was infringed. Instead, the Federal Circuit panel required that for enhanced damages, there must be “at least a showing of objective recklessness” on the part of the potential infringer. *In re Seagate Tech. LLC*, 497 F.3d 1360, 1371 (Fed. Cir. 2007) (en banc).

35 U.S.C. § 298: Advice of Counsel

President Obama signed the America Invents Act (AIA) into law on September 16, 2011. Chapter 29 of title 35, United States Code, is entitled “Remedies for Infringement of Patent, and Other Actions.” Section 17(a) of the AIA amends chapter 29, by adding at its end, the following:

§ 298. Advice of counsel

The failure of an infringer to obtain the advice of counsel with respect to any allegedly infringed patent, or the failure of the infringer to present such advice to the court or jury, may not be used to prove that the accused infringer willfully infringed the patent or that the infringer intended to induce infringement of the patent.

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In effect, section 298 protects defendants in a patent action from being liable for enhanced damages for willful infringement based entirely on whether or not a patent opinion was obtained. Prior to *In re Seagate*, defendants were in a precarious position with regard to this advice-of-counsel issue. If the potential infringer did obtain advice of counsel, upon asserting an advice-of-counsel defense to refute the willfulness allegation, the potential infringer waived privilege as to both attorney-client communications and communicated work product regarding the subject matter of the opinion. See *In re EchoStar Commc'ns Corp.*, 448 F.3d 1294, 1302–3 (Fed. Cir. 2006). If, however, the potential infringer did not obtain advice of counsel as to infringement, there could be a presumption that if the potential infringer infringed, it did so willfully. Section 298 simply codifies the premise asserted by the Federal Circuit in *In re Seagate*, that the failure of an infringer to obtain the advice of counsel, or to present such advice to the court or jury, with respect to any allegedly infringed patent, may not be used to prove that the accused infringer willfully infringed the patent.

Pleading Willful Infringement

The America Invents Act provides no clarification for pleading willful infringement. Therefore, recent decisions will be helpful in pleading and proving willful infringement. In *Mitutoyo Corp. v. Central Purchasing LLC*, the Federal Circuit held that Mitutoyo's complaint was "plainly more than sufficient to meet the requirements of Rule 8(a)(2) for pleading a willful infringement claim and avoid dismissal under Rule 12(b)(6)." 499 F.3d 1284, 1290–91 (Fed. Cir. 2007) (reversing the district court's dismissal of patentee's willful infringement claim for being insufficiently pled). Mitutoyo's complaint alleged, in part, that "[t]he acts of infringement by Central Purchasing have occurred with full knowledge of U.S. Patent No. 4,743,902 and have been willful and deliberate, making this case exceptional within the meaning of the United States patent laws." *Id.* at 1290.

Since *Mitutoyo*, defendants have attacked willfulness pleading from another angle. In *Milwaukee Electric Tool Corp. v. Hitachi Koki, Ltd.*, the court had to determine whether Milwaukee's allegation of willful infringement should be considered an independent claim under Federal Rule of Civil Procedure 8(a)(2) or as part of its request for enhanced damages pursuant to Rule 8(a)(3). No. 09-C-948, 2011 WL 665439, at *4 (E.D. Wis. Feb. 14, 2011). The court chose to treat the allegation of willful infringement as a claim under Rule 8(a)(2) for purposes of the defendants' motion to dismiss. In denying Hitachi's motion to dismiss, the court held that "[u]ltimately, the plaintiffs' allegation that the defendants were aware of the plaintiffs' five patents that the defendants allegedly had infringed and continued to infringe upon, is sufficient to plead willful infringement in the context of the plaintiffs' request for a finding of willful infringement and treble damages." *Id.* at *5. Milwaukee pled adequate factual detail to set forth a facially plausible willfulness claim and also to provide the defendants with adequate notice of that claim. *Id.* Milwaukee's complaint alleged willfulness as follows: "Hitachi was aware of the '257 patent prior to the filing of this Amended Complaint." Amended Complaint for Patent Infringement, *Milwaukee Elec. Tool Corp. v. Hitachi Koki, Ltd.*, No. 09-C-948, 2009 WL 5138003 (E.D. Wis. Nov. 19, 2009).

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The court went on to state that although *In re Seagate* sets forth the standard for establishing willful infringement, the defendants failed to recognize that *In re Seagate* is not controlling for purposes of pleading under Rule 8(a). *Milwaukee*, 2011 WL 665439 at *3. Several courts have noted that, as far as willfulness pleading is concerned, “*Seagate* is not appropriate for the pleading stage of litigation.” *Id.* In conclusion, Rule 8(a)(2) requires only allegations of infringement and knowledge of the asserted patent by the potential infringer.

Proving Willful Infringement

Moving past the pleading stage, it is important to note that determination of whether infringement is willful is a factual question that must be proven by clear and convincing evidence. *Acumed LLC v. Stryker Corp.*, 483 F.3d 800, 804 (Fed. Cir. 2007). The stage at which the willfulness issue is addressed by the court varies by jurisdiction. *See, e.g., B. Braun Med. Inc. v. Abbott Labs.*, 32 U.S.P.Q.2d 1211, 1215 (E.D. Pa. 1994) (ordering bifurcation of willfulness and damages from liability phase); *Great Northern Corp. v. Davis Core & Pad Co., Inc.*, 782 F.2d 159, 167 (Fed. Cir. 1986) (determining willfulness and award of treble damages in liability phase).

A two-prong analysis must be made to determine whether there is willful infringement. *In re Seagate* established a threshold, objective standard to find willful infringement—“objective recklessness.” In this first prong, a plaintiff “must show by clear and convincing evidence that the infringer acted despite an objectively high likelihood that its actions constituted infringement of a valid patent.” *In re Seagate*, 497 F.3d at 1371. Significantly, the “state of mind of the accused infringer is not relevant. . . .” *Id.* *In re Seagate* further established that failure to obtain an exculpatory opinion of counsel is not of itself probative of willful infringement. *Spectralytics, Inc. v. Cordis Corp.*, 649 F.3d 1336, 1347 (Fed. Cir. 2011). Once willful infringement is found, “it is inappropriate to discount evidence relating to whether there was adequate investigation of adverse patent rights.” *Id.* at 1348.

If the first prong is satisfied, the analysis moves to the second prong—the plaintiff must show that the “objectively-defined risk . . . was either known or so obvious that it should have been known to the accused infringer.” *Id.* This second prong analysis is a subjective inquiry. *Uniloc USA, Inc. v. Microsoft Corp.*, 632 F.3d 1292, 1310 (Fed. Cir. 2011), *reh’g denied*, 420 F. App’x 992 (Fed. Cir. 2011). The test for willfulness is distinct and separate from the factors guiding a district court’s discretion regarding enhanced damages. *i4i Ltd. P’ship v. Microsoft Corp.*, 598 F.3d 831, 859 (Fed. Cir. 2010), *aff’d*, 131 S. Ct. 2238 (2011).

Enhanced Damages: Applying the *Read* Factors

Once willfulness has been established, the court must exercise its discretion in deciding whether, and to what degree, it will award enhanced damages:

In deciding whether to enhance damages, the district court properly declined to reapply the test for willfulness set out in *In re Seagate*. Although a finding of willfulness is a

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prerequisite for enhancing damages under § 284, the standard for deciding whether—and by how much—to enhance damages is set forth in *Read*, not *Seagate*.

Id. (citation omitted).

The Federal Circuit clarified in *Spectralytics* that it did *not* hold that after willful infringement is established, it is improper to consider whether the infringer exercised adequate investigation of any adverse patents. 649 F.3d at 1348.

The paramount determination in deciding to grant enhancement and the amount thereof is the egregiousness of the defendant’s conduct based on all the facts and circumstances. *Rite-Hite Corp. v. Kelley Co.*, 819 F.2d 1120, 1125–26 (Fed. Cir. 1987). In *Read Corp. v. Portec, Inc.*, the Federal Circuit held that it “must consider factors that render defendant’s conduct more culpable, as well as factors that are mitigating or ameliorating.” 970 F.2d 816, 826 (Fed. Cir. 1992), *overruled in part on other grounds by Markman v. Westview Instruments, Inc.*, 52 F.3d 967 (Fed. Cir. 1995), *aff’d*, 517 U.S. 370 (1996). The court went on to establish nine factors for consideration in determining when an infringer “acted in [such] bad faith as to merit an increase in damages awarded against him.” *Id.* The factors are as follows:

1. Whether the infringer deliberately copied the ideas or design of another;
2. Whether the infringer, when he knew of the other’s patent protection, investigated the scope of the patent and formed a good-faith belief that it was invalid or that it was not infringed;
3. Infringer’s behavior as a party to the litigation;
4. Defendant’s size and financial condition;
5. Closeness of the case;
6. Duration of the defendant’s misconduct;
7. Remedial action by the defendant;
8. Defendant’s motivation for harm; and
9. Whether the defendant attempted to conceal its misconduct.

Id. at 827 (citations omitted).

The Federal Circuit also stated that a plaintiff should implement self-help by seeking a preliminary injunction for post-filing willful infringement. *In re Seagate*, 497 F.3d at 1374. Further, the court held that a plaintiff who fails to assert its exclusive rights via a preliminary injunction should not be allowed to accrue enhanced damages. The process of a plaintiff asserting its rights seems to be the primary concern of the court, as it conceded that a substantial question about invalidity or infringement is likely sufficient not only to avoid a preliminary injunction but also a charge of willfulness based on post-filing conduct.

AIA Effective Dates

The provisions of the AIA became, or will become, effective on varying dates. Those provisions of the AIA that state an effective date become effective thereon. However, many of the



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provisions do not state an effective date and so become effective on the one-year anniversary of the AIA’s enactment. Section 35 of the AIA states that:

Except as otherwise provided in this Act, the provisions of this Act shall take effect upon the expiration of the 1-year period beginning on the date of the enactment of this Act and shall apply to any patent issued on or after that effective date.

Therefore, section 17 of the AIA (adding 35 U.S.C. § 298) becomes effective on September 16, 2012.

A Reflection of Case Law

Clearly, section 17(a) of the AIA, 35 U.S.C. § 298, codifies the holding in *In re Seagate*. However, the new provision goes on to track more recent case law. Section 298 states that “the failure of the infringer to present such advice to the court or jury, may not be used to prove that the accused infringer willfully infringed the patent.” 35 U.S.C. § 298. This reflects the premise in *Spectralytics*, where the Federal Circuit held that “the failure to obtain an opinion of counsel or otherwise investigate the patent situation can be considered, in the totality of the circumstances.” 649 F.3d at 1348. Therefore, the district court can consider the potential infringer’s failure to seek advice of counsel in its discretion regarding enhanced damages, not willful infringement. *i4i*, 598 F.3d at 859.

Conclusion

Section 298 of the America Invents Act does not change existing standards for willful patent infringement. Rather, it solidifies the proposition that advice of counsel is not determinative of willful patent infringement by a potential infringer. Although the provision specifically excludes consideration of a potential infringer’s acts as they relate to advice of counsel, it does not preclude them from the court’s consideration for application of its discretion in determining enhanced damages.

Keywords: litigation, intellectual property, America Invents Act, willful infringement, enhanced damages

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Willfulness and the Current State of Trademark Damages Law

By Jonathan A. Menkes – April 18, 2012

In a trademark infringement lawsuit, a determination that a defendant intentionally violated the trademark holder's rights, or engaged in other forms of culpable conduct, can greatly influence the amount and type of damages that a court awards. For instance, where the infringement is willful, a court may award enhanced damages, attorney fees, and prejudgment interest. Because some circuits require willfulness as a predicate to recovering certain kinds of monetary relief, while others instead view it as a factor that a court must weigh, there is little consistency (or clarity) in how courts assess monetary damages.

Trademark Damages Generally

The Trademark Act of 1946 (the Lanham Act) protects against a number of trademark-related violations, including trademark and trade dress infringement, false advertising, dilution, and cyber-squatting. *See* 15 U.S.C. § 1114 (registered trademarks and trade dress); 15 U.S.C. § 1125 (unregistered trademarks and trade dress); § 1125(a)(1)(b) (false advertising); § 1125(c) (dilution); § 1125(d) (cyber-squatting). Once a plaintiff establishes liability for one or more of these causes of action, section 1117(a) allows a plaintiff to recover actual damages, defendant's profits, and the costs of bringing the action. 15 U.S.C. § 1117(a) (2006). For a dilution claim, however, a plaintiff cannot recover monetary damages unless the violation (a likelihood of dilution) is willful. *Id.*

The statute grants courts considerable discretion in awarding damages under section 1117(a). *Burger King Corp. v. Mason*, 855 F.2d 779, 780–81 (11th Cir. 1988). Nonetheless, this discretion must be consistent with principles of equity. *See* 15 U.S.C. § 1117(a). A court has far less discretion where the suit involves use of a counterfeit mark and intentional infringement. 15 U.S.C. § 1117(b). Regardless of the type of damage award, courts must ensure that it constitutes "compensation, and not a penalty." 15 U.S.C. § 1117(a)(3). Although punitive damages are not recoverable under the Lanham Act, they may be recovered under state law unfair competition claims. *See, e.g., Duncan v. Stuetzle*, 76 F.3d 1480, 1490 (9th Cir. 1996). In short, "[t]he goal of section 1117 is to achieve equity between or among parties. . . . Defendant may not retain the fruits, if any, of unauthorized trademark use or continue that use; plaintiff is not, on the other hand, entitled to a windfall." *Bandag, Inc. v. Al Bolser's Tire Stores, Inc.*, 750 F.2d 903, 917–18 (9th Cir. 1984).

Types of Monetary Awards

Even if a plaintiff establishes liability, a court will not automatically grant relief. *See, e.g., Lindy Pen Co. v. Bic Pen Corp.*, 982 F.2d 1400, 1405 (9th Cir. 1993). Instead, a plaintiff must show that the infringement proximately caused some type of injury. *See Ramada Inns, Inc. v. Gadsden Motel Co.*, 804 F.2d 1562, 1564 (11th Cir. 1986). This requirement makes sense given that the standard of proof and measure of damages in a trademark infringement lawsuit are the same as those in other tort actions. *See, e.g., Broan Mfg. Co. v. Associated Distribs., Inc.*, 923 F.2d 1232,

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1235 (6th Cir. 1991); *see also* 5 J. Thomas McCarthy, *McCarthy on Trademarks and Unfair Competition* § 30:72 (4th ed. 2011) (“Plaintiff’s damages should be measured by the tort standard under which the infringer-tortfeasor is liable for all injuries caused to plaintiff by the wrongful act. . .”).

Assuming a violation gives rise to a remedy under section 1117(a), a plaintiff may recover the costs of bringing the action, the damages suffered as a result of the infringement, and an accounting of the defendant’s profits. Confusion and disagreement arise in the latter two types of awards, which are discussed in turn below.

Actual Damages

To prove actual damages, a plaintiff must give the fact finder sufficient evidence to calculate damages to a “reasonable certainty.” *Ware v. Rodale Press, Inc.*, 322 F.3d 218, 226 (3rd Cir. 2003). The corollary of the “reasonable certainty” requirement is that the damages award cannot be too speculative or remote. *Broan*, 923 F.2d at 1235. Despite this requirement, a court will not deny damages merely because the exact amount of damages cannot be ascertained with precision. *WMS Gaming, Inc. v. WPC Prods. Ltd.*, 542 F.3d 601, 608 (7th Cir. 2008). Once the plaintiff proves damages, a court may award “any sum above the amount found as actual damages,” though the statute prohibits an award of greater than three times this amount. 15 U.S.C. § 1117(a)(3). Because marketplace damages can be difficult to prove, most circuits require the plaintiff to provide evidence of actual consumer confusion because such evidence tends to show that the plaintiff actually suffered some type of damage. *See* 2–7 Anne Gilson LaLonde, *Gilson on Trademarks* § 7.02 (2011).

One measure of actual damages is the profits that the plaintiff lost due to the infringement. This is not to be confused with a disgorgement of defendant’s profits that the defendant obtained from using the infringing mark, as discussed below. In *Intel Corp. v. Terabyte Int’l, Inc.*, 6 F.3d 614, 621 (9th Cir. 1993), the district court calculated the plaintiff’s lost profits by multiplying the number of infringing items the defendant sold (computer chips) by the profit margin the plaintiff lost due to the defendant’s sale of the infringing items. The Ninth Circuit affirmed the award and noted that although the district court’s method for determining an award of profits was “somewhat crude,” it was justified in part because the defendant failed to come forward with any evidence that the award was erroneous. *Id.*

Corrective advertising is another means by which a plaintiff can recover actual damages. The goal of a corrective advertising award is to make the plaintiff whole by allowing the plaintiff to recover the cost of advertising undertaken to restore the actual or estimated value of the trademark that was lost because of the infringement. *Adray v. Adry-Mart, Inc.*, 76 F.3d 984, 988 (9th Cir. 1995). Such costs may include future (prospective) corrective advertising. *Binder v. Disability Group, Inc.*, 772 F. Supp. 2d 1172, 1178–79 (C.D. Cal. 2011). As with other forms of compensatory damages, this award is meant to place the plaintiff in the position that they would have occupied had the infringement not occurred. 5 *McCarthy, supra*, § 30:81. A plaintiff that engages in its own corrective advertising may also need to show that such expenditures were

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reasonable under the circumstances and proportionate to the damage due to the infringement. *See, e.g., Balance Dynamics Corp. v. Schmitt Indus., Inc.*, 204 F.3d 683, 692–93 (6th Cir. 2000).

A reasonable royalty rate is yet another measure of plaintiff’s actual damages. *See, e.g., Trovan, Ltd. v. Pfizer, Inc.*, 2000 U.S. Dist. Lexis 7522, at *51–52 (C.D. Cal. 2000) (citing cases). This calculation is common when a plaintiff previously licensed its mark to a defendant. For example, in *Boston Professional Hockey Ass’n v. Dallas Cap & Emblem Manufacturing, Inc.*, 597 F.2d 71, 76 (5th Cir. 1979), the Fifth Circuit held that where the defendant offered to pay \$15,000 for a three-year nonexclusive license to manufacture and sell the emblems of various National Hockey League teams, an award of \$20,000 was appropriate because this was the prorated value of such a royalty over a four-year period (the length of the defendant’s infringement). However, where a plaintiff has not yet licensed its mark to the defendant or a third party, a court is less likely to grant a reasonable royalty, especially if there were no licensing negotiations or other present plans to license the trademark. *Trovan*, 2000 U.S. Dist. Lexis 7522, at *58. Courts should remain hesitant to award a reasonable royalty rate in such circumstances because the award is untethered to the “reasonable certainty” requirement discussed above.

Defendant’s Profits

Typically, a plaintiff may recover lost profit damages by showing the profits that the plaintiff would have earned *but for* the infringement. *See, e.g., Lindy Pen*, 982 F.2d at 1407. Unlike actual damages, which caps the award at treble the amount that a plaintiff proves, the statute does not explicitly provide for an upper limit on profit awards. 15 U.S.C. § 1117(a).

Because it is often difficult (and expensive) for a plaintiff to prove that sales were actually diverted to the defendant, a plaintiff may prefer to seek an accounting of the defendant’s profits because the plaintiff only has to prove the defendant’s sales, while the defendant bears the burden of proving any deductions or other costs to reduce the award. 15 U.S.C. § 1117(a)(3). For example, in *Venture Tape Corp v. McGills Glass Warehouse*, 540 F.3d 56, 64 (1st Cir. 2008), the First Circuit held that once a plaintiff establishes infringement and direct competition with a defendant, the statute places the burden on the defendant to show that its sales were “unrelated to and unaided by [defendants’] illicit use of [plaintiff’s] marks.” An accounting award is more appropriate where the parties are in competition because the plaintiff’s losses are more likely to correspond to the defendant’s gains. *See Polo Fashions, Inc. v. Craftex, Inc.*, 816 F.2d 145, 149 (4th Cir. 1987) (noting that an award of defendant’s profits are “a rough measure of the plaintiff’s damages [and indeed] are probably the best possible measure of damages available.”). As with actual damages, an accounting of profits does not follow automatically upon a showing of infringement. *See Lindy Pen*, 982 F.2d at 1405.

Courts have advanced three justifications for an award of defendant’s profits: (1) approximating the measure of the plaintiff’s harm; (2) preventing the defendant’s unjust enrichment; and (3) deterring a willful infringer from future infringement. *See Tamko Roofing Prods., Inc. v. Ideal Roofing Co, Ltd.*, 282 F.3d 23, 36 (1st Cir. 2002). Courts usually disgorge profits when there is evidence of deliberate infringement by the defendant and where the defendant’s profits exceed

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the amount by which the plaintiff “suffered” damages. When the situation involves noncompeting parties, courts are split on whether “avoiding unjust enrichment” or “detering further infringement” are sufficient justifications for an accounting of profits. *5 McCarthy, supra*, § 30:59. In addition, some courts will not award an accounting of the defendant’s profits unless the plaintiff produces evidence of actual confusion.

The Source of Confusion

In 1999, Congress amended section 35 of the Lanham Act to allow recovery for claims of willful dilution. Pub. L. 106-43, 113 Stat. 218 (1999) (providing for remedies for “a violation under section 1125(a) or (d) of this title, *or a willful violation under section 1125(c) of this title*”) (emphasis added). Since this amendment, a number of circuits wrestled with whether willfulness, or other misconduct, is required to recover defendant’s profits. *See, e.g., GMA Accessories, Inc. v. BOP, LLC*, 765 F. Supp. 2d 457, 469 (S.D.N.Y. 2011) (discussing the effect of the 1999 amendment and noting the intra-district split regarding the impact of the amendment). The uncertainty arose because, prior to the 1999 amendments, some circuits would not award defendant’s profits unless the plaintiff also showed that the defendant acted in bad faith. *See, e.g., Int’l Star Class Yacht Racing Assoc. v. Tommy Hilfiger, U.S.A., Inc.*, 80 F.3d 749 (2d Cir. 1996). While the 1999 amendment included the word “willful” in reference to a violation under section 1125(c), which defines a claim for relief for the dilution of a famous mark, it did not alter the wording that refers to violations of section 1125(a), which governs false advertising and trademark and trade dress infringement claims. Therefore, Congress’s decision to leave section 1125(a) unaltered led some courts to conclude that the amendments changed (or did not change) the established common-law precedent in their circuit regarding the requirement of willfulness as a prerequisite for disgorgement of a defendant’s profits.

By 2005, most circuits required that a plaintiff show some type of willfulness to recover defendant’s profits, though several courts instead held that willfulness is merely one factor to consider for such an award. *5 McCarthy, supra*, § 30:62. Today, a majority of courts hold that an accounting of profits is not available without a showing that the defendant acted willfully. However, because many of these decisions rely on precedent decided before the Lanham Act’s 1999 amendment, the precedent’s vitality is questionable. *See 3–11 Gilson, supra*, § 14.03.

The Current State of Damages

The First Circuit has not yet explicitly decided whether willfulness is a predicate for an award of defendant’s profits under the Lanham Act. In *Tamko*, 282 F.3d at 36 (1st Cir. 2002), the court of appeals stated that because the jury found willfulness, it need not decide the issue of whether willfulness is a precondition for an accounting of defendant’s profits. However, in a footnote, the court acknowledged that willfulness is required where “the rationale for an award of defendant’s profits is to *deter some egregious conduct . . .*” *Id.* at 36 n.11 (emphasis added). More recently, in the context of a default judgment, a district court acknowledged that the First Circuit has not decided the issue and passed on the question because the complaint established willfulness. *N.E. Lumber Mfrs. Ass’n v. N. States Pallet Co., Inc.*, No. 09-290 (D.N.H. Jan. 31, 2011).

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District courts within the Second Circuit remain split over whether actual damages or profits under section 1117(a) require a showing of willfulness, bad faith, or actual confusion. For example, in *Chanel, Inc. v. Veronique Idea Corp.*, No. 10-2587 (S.D.N.Y. June 27, 2011), the court found that a plaintiff may recover damages for violations of section 1125(a) without showing willfulness. By contrast, in *GMA Accessories*, the court found that a plaintiff must establish actual confusion, or at least bad faith, to receive an award of either profits or damages under section 1117(a). 765 F. Supp. 2d at 469.

In *Banjo Buddies, Inc. v. Renosky*, 399 F.3d 168, 175 (3rd Cir. 2005), the Third Circuit advised that when deciding to award defendant's profits (disgorgement of defendant's unjust enrichment), district courts should consider the following factors: (1) whether the defendant had the intent to confuse or deceive; (2) whether the defendant diverted sales; (3) the adequacy of other remedies; (4) the plaintiff's unreasonable delay, if any, in asserting its rights; (5) the public interest in making the misconduct unprofitable; and (6) whether it is a case of palming off. Then again, in *Sabinsa Corp. v. Creative Compounds, LLC*, No. 04-4239 (D.N.J. July 27, 2011), the court, citing *Banjo Buddies*, found that actual confusion and/or willfulness were not required to disgorge the infringer's profits. Similarly, in *Members 1st Federal Credit Union v. Metro Bank*, No. 09-1171 (M.D. Pa. Jan. 21, 2011), the court found that willful conduct is not a prerequisite for disgorgement of profits, though it was an equitable factor that a court should consider. In *Zurco, Inc. v. Sloan Valve Co.*, No. 08-185 (W.D. Pa. Mar. 31, 2011), the court clarified that while actual confusion is a requirement for an award of actual damages under section 1117(a)(2), it was not necessary to recover defendant's profits under section 1117(a)(1).

Courts in the Fourth, Fifth, and Sixth Circuits also consider the six factors discussed in *Banjo Buddies* when deciding whether to award an accounting of defendant's profits. The factors considered by the Fourth, Fifth, and Sixth Circuits are substantially identical. See, e.g., *Synergistic Int'l, LLC v. Korman*, 470 F.3d 162, 174–75 (4th Cir. 2006); *Rolex Watch USA, Inc. v. Meece*, 158 F.3d 816, 823 (5th Cir. 1998); *La Quinta Corp. v. Heartland Prop. LLC*, 603 F.3d 327, 343 (6th Cir. 2010).

The Seventh Circuit, in *Roulo v. Russ Berrie & Co., Inc.*, 886 F.2d 931, 941 (7th Cir. 1989), held that “there is no express requirement . . . that the parties be in direct competition or that the infringer willfully infringe the trade dress to justify an award of profits.”

The Eighth Circuit recently held that actual confusion need not be shown to recover the infringer's profits. *Masters v. UHS Del., Inc.*, 631 F.3d 464, 474 (8th Cir. 2011), *cert. denied*, 131 S. Ct. 2920 (2011). In *Masters*, the Eighth Circuit stated that a requirement of actual confusion would be especially inequitable given the facts of the underlying case. *Id.* There, the defendants breached a licensing agreement by exceeding its scope; thus, evidence of direct testimony or consumer surveys (i.e., actual confusion) would not demonstrate whether the parties remained faithful to the terms of the license agreement. *Id.* With regard to willfulness, however, Judge Wollman acknowledged the circuit split and held that “[f]or purposes of adjudicating this



appeal, we assume, without deciding, that willful infringement is a prerequisite of monetary relief.” *Id.* at 472 n.2.

The Ninth Circuit does not appear to require a showing of actual consumer confusion for recovering an accounting of defendant’s profits, though it is evidence of the likelihood of confusion, and a likelihood of confusion is necessary to establish liability. *Gracie v. Gracie*, 217 F.3d 1060, 1068 (9th Cir. 2000) (“[A] showing of actual confusion is not necessary to obtain a recovery of profits.”). However, when a plaintiff seeks defendant’s profits under an unjust enrichment theory, a plaintiff may have to show willful infringement. *See Adray*, 76 F.3d 984, 988 (9th Cir. 1995).

To receive an award of defendant’s profits in the Tenth Circuit, a court must find that the defendant’s actions were willful or in bad faith, and where this is shown, the court must weigh the equities to tailor the remedy to the specific facts of the case. *W. Diversified v. Hyundai Motor Am.*, 427 F.3d 1269, 1273 (10th Cir. 2005). Such equitable considerations include whether the plaintiff lost sales due to the infringement, whether the defendant profited from the goodwill associated with the plaintiff’s mark, and whether the infringement gave rise to actual consumer confusion or deception. *Id.*

In the Eleventh Circuit, a plaintiff must show actual confusion to recover actual damages; however, an award of defendant’s profits is not conditioned on a showing of actual confusion. *Keg Techs., Inc. v. Laimer*, 436 F. Supp. 2d 1364, 1373 (N.D. Ga. 2006).

In the D.C. Circuit, evidence of bad faith or willfulness is a prerequisite to an award of an infringer’s profits. *Reader’s Digest Ass’n v. Conservative Digest*, 821 F.2d 800, 807 (D.C. Cir. 1987) (finding that “a district court generally may award profits under the Lanham Act only when a defendant’s infringement was “willful” or in “bad faith”).

Conclusion

As Professor McCarthy notes, the case law regarding trademark damages is a “confusing mélange of common law and equity principles, sometimes guided (and misguided) by analogies to patent and copyright law, and finding little statutory guidance in the Lanham Act.” 5 *McCarthy, supra*, § 30:57. Although the confusion and inconsistency stem from a variety of sources, including the amendments to the Lanham Act and judicial interpretation of those amendments, it is time for appellate courts to weigh in and determine whether willfulness is a requirement for recovery of a defendant’s profits, as this is the only hope of adding clarity to this bewildering area of law.

Keywords: litigation, intellectual property, trademark damages, monetary awards, Lanham Act

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Is Actual Confusion Required to Recover Actual Damages?

By Charlene R. Marino – April 18, 2012

Section 35 of the Lanham Act, 15 U.S.C. § 1117(a), governs the award of monetary remedies in trademark infringement and unfair competition cases, and provides, in part, for “(1) defendant’s profits, (2) any damages sustained by the plaintiff, and (3) the costs of the action.” While only a likelihood of confusion is needed to establish liability, and the plain language of section 35 does not require that a prevailing plaintiff prove actual confusion to be entitled to the listed remedies, courts generally have implied such a requirement with respect to the recovery of actual damages. J. Thomas McCarthy, *McCarthy on Trademarks and Unfair Competition* § 30:74 (4th ed. 2011). The Tenth Circuit articulated this distinction between proving liability and proving damages in *Brunswick Corp. v. Spinit Reel Co.*:

Although damages may be awarded for a violation of section 43(a), the award is distinguishable from injunctive relief, because plaintiff bears a greater burden of proof of entitlement. Likelihood of confusion is insufficient; to recover damages plaintiff must prove it has been damaged by actual consumer confusion or deception resulting from the violation.

832 F.2d 513, 525 (10th Cir. 1987).

There is a great deal of semantic confusion regarding what constitutes “damages” under the Lanham Act. This lack of clarity in the case law stems in part from the tendency of some courts to collapse different forms of monetary relief into a single category they call “damages,” thereby failing to distinguish between the equitable remedy of an accounting of the “defendant’s profits” and the legal remedy of an award of the plaintiff’s “damages.” *McCarthy, supra*, § 30:57.

The two forms of recovery, however, are different in nature and in the kind of proof needed to support them, and parties seeking relief should be aware of these distinctions. Recovery of defendant’s profits is a remedy that is equitable in nature, and it flows not from the trademark owner’s injury or damage, but from the infringer’s unjust enrichment or the need for deterrence. *Web Printing Controls Co. v. Oxy-Dry Corp.*, 906 F.2d 1202, 1205 (7th Cir. 1990); *see Burger King v. Mason*, 855 F.2d 779, 781 (11th Cir. 1988) (“[T]he law in this Circuit is well settled that a plaintiff need not demonstrate actual damage to obtain an award reflecting an infringer’s profits under § 35 of the Lanham Act, 15 U.S.C.A. § 1117. . . . An accounting for profits has been determined by this Court to further the congressional purpose by making infringement unprofitable, and is justified because it deprives the defendant of unjust enrichment and provides a deterrent to similar activity in the future.”). Because of this, courts generally agree that proof of actual confusion is not required to support an accounting of a defendant’s profits. *See Choice Hotels Int’l, Inc. v. Pennave Assocs.*, 43 F. App’x 517, 519 (3d Cir. 2002) (holding “it is clear from the statute itself that an award of profits is not conditioned upon an award of damages,” and thus evidence of confusion was not required to support an award of defendant’s profits).

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Actual damages, on the other hand, are to compensate the plaintiff for any actual injury resulting from the infringement and can include compensation for the plaintiff's lost profits, a reasonable royalty, a diminution of the value of the plaintiff's mark or damage to its reputation, or the costs of corrective advertising. *Taco Cabana Int'l, Inc. v. Two Pesos, Inc.*, 932 F.2d 1113, 1128 (5th Cir. 1991) (affirming a jury award of \$306,000 for lost profits and \$628,300 for lost income from franchise fees and royalties); *Ramada Inns, Inc. v. Gadsden Motel Co.*, 804 F.2d 1562, 1565 (11th Cir. 1986) (affirming award of a reasonable royalty as plaintiff's actual damages); *Zelinski v. Columbia 300, Inc.*, 335 F.3d 633, 639–40 (7th Cir. 2003) (affirming award of lost profits and costs of corrective advertising). To recover actual damages, a plaintiff must show some sort of compensable injury. The general rule is that a plaintiff must prove actual injury with proof that some consumers were actually confused or deceived (*McCarthy, supra*, § 30:74 (citing *Restatement (Third) of Unfair Competition* § 36 cmt. i (1995))), but courts vary in the application of this rule.

Of the circuits that have addressed this issue, the Second Circuit is the most strict in requiring direct proof of actual confusion before actual damages may be awarded. However, not all courts are as rigid in assessing whether a plaintiff has adduced evidence sufficient to prove a compensable injury, particularly because direct evidence of actual confusion is often difficult to obtain (or “proving actual confusion is often difficult”). *Id.* In these jurisdictions, including the Tenth Circuit, courts have accepted circumstantial evidence of confusion such as consumer surveys in permitting actual damages awards. *Brunswick Corp.*, 832 F.2d at 525 (“Actual consumer confusion may be shown by direct evidence, a diversion of sales or direct testimony from the public, or by circumstantial evidence such as consumer surveys.”).

At the other end of the spectrum are the Fifth, Ninth, and Eleventh Circuits, which permit recovery based on all elements of injury to the business of the trademark owner caused by the infringement, such as injury to business reputation or goodwill of the mark. *See Aronowitz v. Health-Chem Corp.*, 513 F.3d 1229, 1241 (11th Cir. 2008) (upholding jury's award of damages in trademark infringement case where jury was properly instructed that “damages sustained by the plaintiff” included “all elements of injury to the business of the trademark owner proximately resulting from the infringer's wrongful acts” such as injury to business reputation or goodwill); *Boston Prof'l Hockey Ass'n, Inc. v. Dallas Cap & Emblem Mfg.*, 597 F.2d 71, 75 (5th Cir. 1979) (upholding award of a reasonable royalty on ground that plaintiff had sustained injury to its brand and business reputation). This more flexible approach allows an injured plaintiff to be compensated where direct evidence of actual confusion is not available or where the defendant has not profited from its infringement.

Actual Confusion or Deception Required

In the Second Circuit, it is well established that proof of actual confusion is required to support an award of actual damages, as expressed in *Boosey & Hawkes Music Publishers, Ltd. v. Walt Disney Co.*, 145 F.3d 481 (2d Cir. 1998): “Our case law is well settled that in order for a Lanham Act plaintiff to receive an award of damages the plaintiff must prove either actual consumer

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confusion or deception resulting from the violation, . . . or that the defendant’s actions were intentionally deceptive thus giving rise to a rebuttable presumption of consumer confusion.” *Id.* at 493.

Based on this precedent, courts in the Second Circuit consistently have denied actual damages where the plaintiff failed to adduce evidence of actual confusion. For example, in *International Star Class Yacht Racing Ass’n v. Hilfiger U.S.A., Inc.*, 80 F.3d 749 (2d Cir. 1996), the Second Circuit affirmed the district court’s denial of actual damages to the owner of the mark STAR CLASS in connection with the plaintiff’s yachting association and related goods. The district court had found that the mark was infringed by the defendant’s use of the same mark on clothing. Although the district court granted injunctive relief, actual damages were found to be unavailable because the plaintiff offered no evidence of actual confusion caused by the defendant’s use of the STAR CLASS mark and no evidence of pecuniary loss. *Id.* at 753. *See also Info. Superhighway, Inc. v. Talk Am.*, 395 F. Supp. 2d 44, 55 (S.D.N.Y. 2005) (dismissing plaintiff’s request for monetary damages where there was “no evidence of actual confusion, money damages, or willful deception”). *But see Mr. Water Heater Enters., Inc. v. 1-800-Hot Water Heater, LLC*, 648 F. Supp. 2d 576, 590 (S.D.N.Y. 2009) (denying defendant’s motion for summary judgment on issue of damages because, “[while] Plaintiffs fail[ed] to show actual confusion, a question of fact exist[ed] as to whether Defendants acted in bad faith”).

The Seventh Circuit adopted similar requirements in *Web Printing Controls Co. v. Oxy-Dry Corp.*, 906 F.2d 1202 (7th Cir. 1990), in which it affirmed the district court’s denial of actual damages where the plaintiff failed to prove that the defendant’s “reverse passing off” in using its own mark on plaintiff’s goods caused actual consumer confusion and that, as a result, the plaintiff suffered actual injury. *Id.* at 1205. The court subsequently set a low threshold for the amount of actual confusion evidence necessary to support an award of actual damages in *Zelinski v. Columbia 300, Inc.*, 335 F.3d 633 (7th Cir. 2003). In that case, the court upheld an award of money damages for corrective advertising and lost royalties based on two anecdotal instances of reported confusion, finding that this evidence, while “not overwhelming,” was “sufficient” to support the jury’s award. *Id.* at 639. *But see Badger Meter, Inc. v. Grinnell Corp.*, 13 F.3d 1145, 1157 (7th Cir. 1994) (affirming denial of actual damages, but noting in dicta that even if a plaintiff is unable to demonstrate actual damages, section 1117 allows the district court to award the plaintiff any just monetary award so long as it constitutes “compensation” for the plaintiff’s losses or the defendant’s unjust enrichment and is not simply a “penalty” for the defendant’s conduct).

In the Tenth Circuit, although a plaintiff must prove that it has been damaged by actual consumer confusion, this may be shown by circumstantial evidence. *Brunswick Corp.*, 436 F.2d at 525. Thus, in *Australian Gold, Inc. v. Hatfield*, 436 F.3d 1228 (10th Cir. 2006), the court affirmed the jury’s award of \$450,000 in actual damages for the defendant’s trademark infringement even while finding that the plaintiffs “did not offer any direct evidence of actual confusion.” *Id.* at 1240, 1242. The court found that the plaintiffs “clearly suffered damages” as a result of the

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defendant's infringement in the form of "doubtless" lost sales from the defendant's use of the plaintiffs' trademarks to lure customers to a website on which it advertised and sold competing products, causing the plaintiffs to lose opportunities for up-selling that occurred when the plaintiffs' products were sold in salons. Because the plaintiffs were able to show some form of damage that they sustained as a result of the infringement, the submission of actual damages to the jury was appropriate. *Id.* at 1241–42.

Other Elements of Trademark Injury

Other courts are even more flexible in awarding relief to an aggrieved plaintiff based on the totality of the evidence where direct evidence of actual confusion is not available. The Fifth Circuit has long held that actual confusion is not a prerequisite to an award of money damages in that jurisdiction. *Taco Cabana Int'l, Inc. v. Two Pesos, Inc.*, 932 F.2d 1113, 1126 (5th Cir. 1991); *Boston Prof'l Hockey Ass'n, Inc. v. Dallas Cap & Emblem Mfg.*, 597 F.2d 71, 75 (5th Cir. 1979). The court most recently affirmed this precedent in *Board of Supervisors for Louisiana State University Agricultural & Mechanical College v. Smack Apparel Co.*, 550 F.3d 465 (5th Cir. 2008), in which it upheld the jury's award of actual damages and found that the district court did not err in allowing the issue of actual damages to go to the jury even though the plaintiff had not offered direct evidence of confusion. *Id.* at 490 (citing *Taco Cabana*, 932 F.2d at 1126).

The Eleventh Circuit, recognizing that section 35 of the Lanham Act gives "district judges wide discretion in determining a just amount of recovery for trademark infringement," allows recovery for "all elements of injury to the business of the trademark owner proximately resulting from the infringer's wrongful acts." *Ramada Inns, Inc. v. Gadsden Motel Co.*, 804 F.2d 1562, 1564 (11th Cir. 1987) (citations omitted). Injury to the trademark owner can include "injury to business reputation or goodwill," as the court recognized in *Aronowitz v. Health-Chem Corp.*, 513 F.3d 1229 (11th Cir. 2008). In that case, the court upheld an award of damages for trademark infringement where the plaintiff presented evidence "regarding damages to [its] reputation and goodwill." The court found that the testimony presented "could have figured into the jury's consideration of the damages instruction it was given which called for assessment of any injury or loss to Health-Chem's reputation, goodwill, general business reputation, sales, or deception of customers, as well as corrective advertising." *Id.* at 1241.

The Ninth Circuit also has long recognized that a plaintiff may sustain injury in the form of damage to the goodwill of its brand. *See, e.g., Playboy Enters., Inc. v. Baccarat Clothing Co.*, 692 F.2d 1272, 1275 (9th Cir. 1982) ("As a result of this trademark infringement . . . the reputation and goodwill of the trademark owner is accordingly harmed"); *Maier Brewing Co. v. Fleischmann Distilling Co.*, 390 F.2d 117, 122 (9th Cir. 1968) (criticizing diversion of sales as the lone measure of harm and noting, "These courts are protecting the trademark owner from only the most obvious form of damages, the diversion of sales, and are not in fact providing protection to the value of the goodwill built up in the trade-mark itself."). In the seminal case *Lindy Pen Co. v. Bic Pen Corp.*, 982 F.2d 1400 (9th Cir. 1993), the court adopted a broad approach and reasoned that relief to an aggrieved plaintiff should be "based on the totality of the



circumstances,” and thus defined “damages” as measured by “any direct injury which a plaintiff can prove.” The court explained:

Other jurisdictions have made a distinction between the elements necessary to establish a legal basis for liability from those required for proof of damages. Although we recognize this distinction, “[n]evertheless, an inability to show actual damages does not alone preclude a recovery under section 1117.” In so holding, we express a distinct preference for those opinions permitting relief based on the totality of the circumstances.

Id. at 1410–11.

The court ultimately found that the plaintiff failed to sufficiently prove the amount of damages but that it presented sufficient proof that it was entitled to damages. *Id.* at 1409–10.

Expanding on *Lindy Pen*, the court in *Southland Sod Farms v. Stover Seed Co.*, 108 F.3d 1134 (9th Cir. 1997), explained that the proof sufficient to establish actual injury as a result of infringement can include the results of consumer surveys, direct testimony, and market analyses. *Southland Sod*, 108 F.3d at 1146 (“[T]he consumer survey testimony . . . and the market analysis testimony . . . provide adequate evidence for a reasonable jury to conclude that Plaintiffs suffered actual injury as a result of Defendants’ advertisements.”).

Conclusion

When seeking monetary relief in the form of actual damages, a trademark plaintiff must show a compensable injury to recover damages. Depending on the jurisdiction, however, relief to an injured plaintiff is not necessarily foreclosed if evidence of actual consumer confusion is unavailable. Rather, a claim for actual damages can properly be based on all elements of injury to the business of the trademark owner, such as injury to business reputation or the mark’s goodwill. This injury may be proven by direct testimony regarding damage to trademark goodwill, expert testimony, the results of consumer surveys, or market analyses. Where the plaintiff cannot proffer evidence of any compensable injury, relief in the form of an accounting of the defendant’s profits is still an available remedy under section 35.

Keywords: litigation, intellectual property, actual damages, trademark infringement

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The Increased Scrutiny of Reasonable Royalty Damages Awards

By Steven R. Hansen – April 18, 2012

In *Uniloc USA Inc. v. Microsoft Corp.*, 632 F.3d 1292 (Fed. Cir. 2011), the Court of Appeals for the Federal Circuit signaled that reasonable royalty damages awards in patent cases would be held to a higher level of scrutiny than in the past. The court condemned the widely used “25 percent rule of thumb” for apportioning the profits accruing from sales of an infringing product between a patent holder and infringer and also clamped down on the use of the “entire market value” rule for determining the “base” to which a royalty percentage would be applied. *Uniloc* came on the heels of *Lucent Technologies, Inc. v. Gateway, Inc.*, 580 F.3d 1301 (Fed. Cir. 2009), which restricted the range of licenses that could be considered in performing a reasonable royalty analysis. While the decisions may be hailed as an effort to curb windfall damages awards, especially for seemingly “minor” improvement patents, they require a level of proof and analysis that may be difficult or, in some cases, impossible to meet. Moreover, because the patent holder bears the burden of proof on damages, the heightened scrutiny of damages proof may ultimately collide with the statutory mandate that patent holders receive no less than a reasonable royalty on a finding of infringement.

Reasonable Royalty Damages

Under 35 U.S.C. § 284, upon a finding of infringement, “the court shall award the claimant damages adequate to compensate for the infringement, but in no event less than a reasonable royalty . . .” “A ‘reasonable royalty’ contemplates a hypothetical negotiation between a patentee and the infringer at the time before the infringement began.” *Riles v. Shell Exploration & Production Co.*, 298 F.3d 1302, 1311 (Fed. Cir. 2002). “The statute guarantees patentees a reasonable royalty even when they are unable to prove entitlement to lost profits or an established royalty rate.” *Id.* While the statute may guarantee a reasonable royalty, “[t]he patentee bears the burden of proving damages.” *Uniloc*, 632 F.3d at 1315.

The so-called *Georgia-Pacific* factors are generally used to arrive at a reasonable royalty and include factors such as the royalties received by the patentee for licensing the patent in suit, the rates paid by the licensee for the use of other similar patents, the nature and scope of the license (e.g., exclusive versus nonexclusive, territorial limitations), the patent holder’s policy regarding maintaining a monopoly or licensing the invention, and the commercial relationship between the parties (e.g., whether they compete). *Georgia-Pacific Corp. v. U.S. Plywood Corp.*, 318 F. Supp. 1116, 1120 (S.D.N.Y. 1970).

The royalty calculation can be done in different ways. For example, a “lump sum” royalty may be determined, which is a fixed amount of money paid by a licensee for use of a patented invention. Alternatively, a “running royalty” tied to the number of units sold by the infringer may be calculated. In the case of a running royalty, the calculation is often broken down into a “royalty base” (e.g., total revenues from the sale of infringing products) and a percentage that is applied to the royalty base to

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arrive at the infringer’s royalty payment to the patent holder. *See Lucent Technologies, Inc. v. Gateway, Inc.*, 580 F.3d 1301, 1325–26 (Fed. Cir. 2009). Because of the nature of the *Georgia-Pacific* factors, expert testimony is typically used to establish reasonable royalty damages.

Uniloc, the 25 Percent Rule, and the Entire Market Value Rule

Ultimately, a reasonable royalty must be grounded in the financial gain that the infringer obtains by virtue of using the patented invention. The question becomes how to use the *Georgia-Pacific* factors in view of the often limited data that are typically available in infringement litigation to arrive at a number. This can become particularly perplexing where the accused product includes unpatented features that may be responsible for the revenues and profits generated by sales of the product.

The 25 Percent Rule

To develop a starting point for arriving at a reasonable royalty, many damages experts have relied on the 25 percent rule. “The 25 percent rule of thumb is a tool that has been used to approximate the reasonable royalty rate that the manufacturer of a patented product would be willing to pay to the patentee during a hypothetical negotiation. The Rule suggests that the licensee pay a royalty equivalent to 25 percent of its expected profits for the product that incorporates the IP at issue.” *Uniloc*, 632 F.3d at 1312. The 25 percent rule has been widely used. As the *Uniloc* court noted, “Lower courts have invariably admitted evidence based on the 25% rule, largely in reliance on its widespread acceptance or because its admissibility was uncontested.” *Id.* at 1314.

No more. The *Uniloc* court pronounced the death of the 25 percent rule, holding “as a matter of Federal Circuit law that the 25 percent rule of thumb is a fundamentally flawed tool for determining a baseline royalty rate in a hypothetical negotiation. Evidence relying on the 25 percent rule of thumb is thus inadmissible under *Daubert* and the Federal Rules of Evidence . . .” *Id.* at 1315. As this holding suggests, many damages experts used the 25 percent rule to obtain a “baseline” royalty, which was then adjusted upward or downward based on the *Georgia-Pacific* factors. Unfortunately, *Uniloc* provides no guidance concerning how to determine a proper baseline royalty figure in the absence of such rules of thumb.

The Entire Market Value Rule

The *Uniloc* court also addressed the applicability of the “entire market value” rule in determining a royalty base. “The entire market value rule allows a patentee to assess damages based on the entire market value of the accused product only where the patented feature creates the ‘basis for customer demand’ or ‘substantially creates the value of the component parts.’” *Id.* at 1318 (citations omitted).

In *Uniloc*, the patent in suit was directed to a software registration system to deter copying. *Id.* at 1298. The accused product was Microsoft’s Product Activation feature that is incorporated into Microsoft Word XP, Word 2003, and Windows XP. *Id.* at 1297. The Microsoft Word products are sold as components of a larger program, Microsoft Office. After applying the 25 percent rule and the *Georgia-Pacific* factors to arrive at a \$560 million-plus royalty, Uniloc’s expert defended his analysis by comparing his royalty with Microsoft’s \$19 billion in sales revenues for Office and Windows and concluding that his royalty was only 2.9 percent of the sales revenues. *Id.* at

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1318. The Federal Circuit held that it was improper and in violation of the entire market value rule to let Uniloc’s expert testify regarding the total sales revenues for Office and Windows because there was no evidence that the entire market value of Outlook and Windows was derived from the patented contribution—the software registration system. *Id.* at 1321. The Federal Circuit affirmed the trial court’s decision to grant a conditional new trial on damages because of the admission of the total revenue evidence, notwithstanding the fact that it was only used as a “check” on the legitimacy of the expert’s royalty figure. *Id.* at 1321.

The *Uniloc* court took issue with Uniloc’s suggestion that the sales prices of Office and Windows were an appropriate royalty base. Relying on *Lucent Technologies, Inc. v. Gateway, Inc.*, 580 F.3d 1301 (Fed. Cir. 2009), Uniloc argued that the particular royalty base was irrelevant as long as the royalty rate was supported by the evidence. *Uniloc*, 632 F.3d at 1319. In *Lucent*, the court held that “the base in a running royalty calculation can always be the value of the commercial embodiment, as long as the magnitude of the rate is within an acceptable range (as determined by the evidence)” *Uniloc*, 632 F.3d at 1319, citing *Lucent*, 580 F.3d at 1338–39. However, the *Uniloc* court limited this part of *Lucent*’s holding based on the “context” of that case and held that “[t]he Supreme Court and this court’s precedents do not allow consideration of the entire market value of accused products simply by asserting a low enough royalty rate.” *Uniloc*, 632 F.3d at 1320. The court went on to hold that “[f]or the entire market value to apply, the patentee *must* prove that the patent-related feature is the basis for customer demand.” *Id.*, citing *Lucent*, 580 F.3d at 1336 (emphasis in original). Unfortunately, *Uniloc* does not explain how a patentee can arrive at a proper royalty base when the entire market value rule does not apply.

Lucent Limits the Licenses Used to Establish a Reasonable Royalty

Based on *Georgia-Pacific*, patentees often look to existing licenses for similar technologies to arrive at a reasonable royalty figure. In *Lucent Technologies, Inc. v. Gateway, Inc.*, 580 F.3d 1301 (Fed. Cir. 2009), the Federal Circuit considered how “similar” such existing licenses must be. In *Lucent*, several Microsoft products, including Outlook, were accused to infringe the patent in suit due to their inclusion of a “date-picker” feature for selecting calendar dates in Outlook’s drop-down calendar. *Id.* at 1317. To arrive at a royalty figure, Lucent’s expert relied on a series of “PC-related patents” between a variety of parties. The court criticized Lucent’s reliance on these agreements, stating that “some of the license agreements are radically different from the hypothetical agreement under consideration for the [patent in suit]” and that “with the other agreements, we are simply unable to ascertain from the evidence presented the subject matter of the agreements.” *Id.* at 1327–28. The court also criticized Lucent’s reliance on several “running royalty” agreements because the royalty sought by Lucent was a lump-sum royalty. *Id.* at 1329. As a result, the court held that the jury’s award of over \$357 million in damages was not supported by the existing license evidence. *Id.* at 1332. One of the licenses involved IBM’s “entire patent portfolio protecting its one-time dominance in the personal computer market.” *Id.* at 1328. Another of the licenses concerned a software development collaboration between Microsoft and Apple. The court was highly critical of Lucent’s failure to connect the licenses to the patented technology, characterizing the evidence as “little more than a recitation of royalty

numbers.” *Id.* at 1330. While rightfully critical of Lucent’s failure to make this connection, the *Lucent* opinion provides little guidance as to how closely existing licenses must be linked to a patented technology to constitute admissible evidence of a reasonable royalty.

The Impact of *Uniloc* and *Lucent* on Patent Holders

The Federal Circuit’s reaction to the jury awards in *Uniloc* and *Lucent* is understandable. Both cases involved a minor patented software feature incorporated into a much larger and otherwise “feature-rich” software package. However, the cases provide little guidance to patent holders who seek to “get it right.” Moreover, they ignore the practical realities and limited information faced by patent litigants in seeking to prove a reasonable royalty figure. These difficulties undoubtedly gave rise to the 25 percent rule in the first place.

Difficulties Obtaining a Reasonable Royalty Analysis

The evidence that is generally available in a patent lawsuit usually includes the infringer’s revenues and profits from sales of the accused product and, in some cases, cost information for various components of the accused product. Companies often do not track the revenues and profits attributable to individual components or features, especially in the case of items like software. Thus, the universe of available financial data can be quite limited. When that is so, how does one arrive at a reasonable royalty base if the salable unit revenues cannot be used because of the inapplicability of the entire market value rule? *Uniloc* provides no guidance on this point but expressly requires that patentees “give evidence tending to separate or apportion the defendant’s profits and the patentee’s damages between the patented feature and unpatented features” based on evidence that is “reliable and tangible, and not conjectural or speculative.” *Uniloc*, 632 F.3d at 1318, citing *Garretson v. Clark*, 111 U.S. 120, 121 4 S. Ct. 291, 28 L. Ed. 371 (1884).

Survey evidence such as that used in trademark cases may be helpful if the accused product is widely sold to third parties. On remand and following the issuance of the *Uniloc* opinion, Lucent’s expert conducted a survey to determine that 7 percent of all purchasers of Outlook who used the drop-down calendar (which incorporated the infringing date-picker) would not have bought the program in the absence of the calendar. *Lucent Technologies, Inc. v. Microsoft Corp.*, No. 3:07-cv-2000, 2011 U.S. Dist. LEXIS 130571, at *20 (S.D. Cal. Nov. 10, 2011). He further determined that 43 percent of all Outlook users used the drop-down calendar and that Microsoft therefore would have lost 3 percent of its 109.5 million Outlook licenses in the absence of the calendar. *Id.* The court accepted this evidence but rejected Lucent’s assertion that the royalty base for each unit of Outlook sold as part of Microsoft Office was \$67 because it was based on the “Home and Student version” of Outlook. *Id.* at *40. Ultimately, the court accepted Microsoft’s contention that because Outlook is one of four programs in Microsoft Office—each of which is priced identically when sold as a stand-alone program—the correct royalty base would be one-fourth of the Microsoft Office sales price. *Id.* at *43–45. The trial court’s decision underscores the difficulty in determining which analysis and which data will be deemed sufficient given the information that is available to patent litigants.

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It is also often quite difficult to find licenses that are “comparable” to the patent in suit, when the patent has not been licensed. By definition, a patentable invention is novel and nonobvious, and the technology covered by licenses to other patents will often differ significantly. In many cases, no licenses are available. In other cases, they are confidential and in the hands of third parties and can only be obtained through third-party discovery.

Parties are often forced to broaden the scope of the licenses on which they rely or perform their royalty analysis without the benefit of any existing royalty data. In many cases, parties will even serve discovery requests for non-patent licenses (i.e., trademark, copyright, and trade secret licenses) in an effort to obtain some hard data with which to begin a reasonable royalty analysis. On remand, the *Lucent* court admitted evidence of two licenses covering “graphical user interfaces such as [patent in suit], and declined to permit the use of other licenses.” *Id.* at *53.

Are Zero Reasonable Royalty Damages Possible?

What happens if a patent holder’s damages case cannot withstand the Federal Circuit’s heightened scrutiny of reasonable royalty awards? For example, in some cases, it may not be possible to conduct surveys or use other techniques to apportion profits between the patented and unpatented features of an accused product. Licenses that are sufficiently comparable may be unavailable. Normally, when a party cannot satisfy its burden on an issue, the court finds against the party and enters judgment accordingly. The burden of proof imposed on patentees suggests that they may not be entitled to any reasonable royalty damages if they cannot satisfy the requirements of *Uniloc* and *Lucent*, a prospect that is more significant in view of the somewhat limited universe of financial data that are available in patent cases.

The patent statute says otherwise, requiring that the patent holder receive “no less than a reasonable royalty.” 35 U.S.C. § 284. How does this requirement square with the burden of proof placed on the patentee and the Federal Circuit’s scrutiny of damages awards?

The case law suggests that the answer is not clear. In *Lindemann Maschinenfabrik v. American Hoist & Derrick Co.*, 895 F.2d 1403 (Fed. Cir. 1990), the Federal Circuit attempted to resolve this apparent tension by holding as follows:

[T]he statute obviates the need to show the fact of infringement when infringement is admitted or proven, but that does not mean that a patentee who puts on *little or no satisfactory evidence* can successfully appeal on the ground that the amount awarded by the court is not ‘reasonable’ and therefore contravenes section 284.

Id. at 1408 (emphasis added).

Notably, *Lindemann Maschinenfabrik* cites the Third Circuit’s opinion in *Devex Corp. v. General Motors Corp.*, 667 F.2d 347 (3d Cir. 1981), in which that court held that “[i]n the absence of any evidence as to what would constitute a reasonable royalty in a given case, a fact finder would have no means of arriving at a reasonable royalty, and none could be awarded.” *Id.* at 361. Some district courts have read *Lindemann Maschinenfabrik* to mean that “[w]here the



record lacks any evidence of a reasonable royalty rate, the Federal Circuit has approved of awarding ‘zero damages’” *Boston Scientific Corp. v. Johnson & Johnson*, 550 F. Supp. 2d 1102, 1120 (N.D. Cal. 2008). See also *KEG Techs., Inc. v. Reinhart Laimer*, 436 F. Supp. 2d 1364, 1370 (N.D. Ga. 2006). In *DePuy Spine, Inc. v. Medtronic Sofamor Danek, Inc.*, 567 F.3d 1314, 1335 (Fed. Cir. 2009), the Federal Circuit affirmed a judgment of a zero percent royalty rate but did so based on the patentee’s failure to raise a timely objection to the verdict under the regional circuit’s law.

The “zero royalty” cases may perhaps be distinguished from those in which a patent holder puts on a colorable, albeit legally insufficient, damages case as the former cases tend to involve situations where the patent holder forgoes putting in evidence of reasonable royalty damages. The *KEG Technologies* court expressly interpreted the Federal Circuit precedents as requiring a “do-over” if the proof turns out to be inadequate and as distinguishing such cases from those in which the patent holder initially elects to forgo reasonable royalty damages altogether. *KEG Technologies*, 436 F. Supp. 2d at 1371 n.3. Both the *Uniloc* and *Lucent* decisions followed this “do-over” approach. However, is it workable to keep remanding cases until the parties get it right, especially when the Federal Circuit’s increased level of scrutiny suggests that reasonable royalty awards are more likely to be deemed insufficiently supported? Such an approach is inefficient and taxes an overburdened court system.

Is It Time to Consider a Statutory Damages Regime in Patent Law?

Unlike the patent statute, the copyright statute allows a copyright holder to elect “statutory damages” in an infringement suit in an amount of not less than \$750 or more than \$30,000 for any one work. 17 U.S.C. § 504. While these amounts may be less than would be appropriate in the case of patent infringement, it may be worth considering whether to provide a fixed award or fixed range of awards as the “floor” in cases of patent infringement. This could avoid the need for either a “do-over” or a zero damages award where the patentee’s reasonable royalty case is insufficient to pass Federal Circuit muster. Given that the “fact of infringement establishes the fact of damage because the patentee’s right to exclude has been violated,” *Lindemann Maschinenfabrik*, 895 F.2d at 1406, it is reasonable to set some minimum amount of compensation to which a patent holder would be entitled upon a finding of infringement, while at the same time minimizing the burden currently placed on the courts by remanding and re-trying damages issues. While the Federal Circuit may be applauded for demanding greater rigor in damages analyses, patent holders should be guaranteed some compensation for the unauthorized use of their inventions without the need for a damages “do-over.”

Keywords: litigation, intellectual property, patents, reasonable royalty damages, statutory damages

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NEWS & DEVELOPMENTS

Apple Battles Samsung for Smartphone/Tablet Market

Trying to decide whether to buy a Samsung Galaxy Tab 10.1 or one of Apple's iPads? If you are currently in Europe, a battle has been escalating between the two companies, and each is trying to make that decision a lot easier by having the other banned. Since April 2011, Apple and Samsung have been in court over each company's respective smartphones and tablet computers. It began with [Apple claiming that Samsung had "slavishly" copied its technology](#), distinctive user interface, and even packaging design when it came to several of Samsung's smartphones and its Galaxy Tablets.

In August 2011, the first of the patent-infringement claims asserted by Apple was resolved in Europe. A [court in the Hague dismissed all of Apple's claims](#) other than those relating to one patent: EP 2059868. The remaining patent covers Apple's interface for viewing and navigating through photos on a touchscreen phone. Apple was granted a preliminary injunction against Samsung sales, limited to phones due to the scope of the patent, including Samsung's Galaxy S, Galaxy S II, and Galaxy Ace models. Though the injunction on its surface may be directed to sales from the Netherlands to other European countries, Samsung's distribution may effectively expand the injunction to a "de facto European-wide ban." Samsung itself, however, has questioned the importance of the injunction.

Turning to tablets, in August 2011, [Apple sued in the Netherlands](#) to have Samsung's Galaxy Tab 10.1 banned there. However, the court held that Samsung's tablet was sufficiently different from Apple's European design patent for Apple's iPad and thus declined to ban the tablet computer. More recently, in January, Apple had its appeal of that ruling dismissed. Samsung has used these decisions to bolster its arguments that Samsung is an innovator who is being unfairly targeted.

Samsung has also taken the offensive, suing Apple in Germany. A district court in Mannheim, Germany, has ruled, however, that Apple did not infringe the patent asserted by Samsung against the iPhone and iPad. Apple returned the volley by filing a new lawsuit in Düsseldorf, Germany, aimed at another 10 models in Samsung's Galaxy family of smartphones.

Lest the reader think that all the excitement is happening abroad, a judge in San Jose recently [ordered Samsung to turn over pre-production samples](#) of its Droid Charge, Infuse 4G, Galaxy S II, and Galaxy Tab 10.1 and 8.9 to Apple—all products that Samsung is preparing to introduce to the U.S. market. [Samsung was later ordered to produce source code](#) for its products to Apple as well. The court allowed this discovery so that Apple can determine whether or not to seek a preliminary injunction against any or all of the produced smartphones. The results of discovery, however, are limited to outside counsel eyes only, so neither Apple nor its in-house counsel will get to see Samsung's products or marketing. Samsung has turned the tables back on Apple,



asking for Apple to [hand over information on the iPad 3 and iPhone 5](#), so as to head off any additional infringement claims from Apple down the road. This seems unlikely, as Samsung has already released samples and images of its own forthcoming products to the media and limited members of the public, whereas such images and samples are not yet available for the iPad 3 and iPhone 5.

There will probably not be a resolution to this conflict anytime soon, as each side tries to keep from losing its market in the United States and in Europe. However, a compromise between the two companies could happen. Who knows? Maybe there is an app for that.

Keywords: litigation, intellectual property, smartphone, Galaxy, Samsung, Apple, iPad

—*Isabel Ajuria, NYU School of Law, Class of 2014*

Federal Circuit Gives ITC Jurisdiction over Chinese Actions

In a 2–1 decision, the Federal Circuit has decided that the International Trade Commission (ITC) has statutory authority to prevent the importation of goods that were made in China by a secret process developed in the United States by a U.S. company where the process was obtained through trade-secret misappropriation in China. *TianRui Group Co. v. International Trade Commission*, 661 F.3d 1322, Case No. 2010-1395 (Fed. Cir. Oct. 11, 2011).

Some will no doubt argue that this decision is court-sponsored protectionism. Good or bad, it provides a vehicle for U.S. companies to protect the misuse of their intellectual property rights in China if the misappropriator imports goods into the United States that were created using intellectual property protected under U.S. law.

Keywords: litigation, intellectual property, Federal Circuit, China, International Trade Commission, trade secrets

—*Vic Souto, WilmerHale, New York, New York*

ICANN Begins Expansion of the Domain Name System

Beginning on January 12, 2012, the [Internet Corporation for Assigned Names and Numbers](#) (ICANN) has been accepting applications for new generic Top-Level Domains (gTLDs). gTLDs are roots such as .com, .gov, and .org used to indicate the character of the owner of an address or the intended purpose of the site located there. ICANN's decision to allow new gTLDs represents one of the largest-ever expansions of the internet landscape, as it will allow a broad range of parties, including businesses, cities, and industry groups, to register their own unique domain names. There are currently 22 existing gTLDs, in addition to approximately 225 country-specific



domain names. But this new program would allow for the registration of any generic word, including .brand, as well as the registration of domain names with non-Latin characters.

ICANN is instituting a rigorous and expensive [application process](#) for the first phase of this expansion, with a March 29, 2012, deadline to initially register and April 12, 2012, as the last day to submit the actual application for a new gTLD string. The time and expense of this application process may deter some potential applicants. Applicants must pay an initial \$5,000 registration fee, which will be credited against a \$185,000 application fee on an official submission for each independent string. Initially, there will also be quarterly maintenance fees of \$6,250. In addition to these financial hurdles, applicants will undergo a 9–20 month, multi-phased approval process. On May 1, 2012, ICANN will publicly reveal all applied-for domain names, and the initial evaluation will begin on June 2. During this evaluation, third-party evaluators will consider a variety of issues, including the applicant’s intended implementation of the gTLD string, whether similarities exist with existing domain names or other requested gTLDs, whether applicants have demonstrated appropriate technical standards and financial resources, and whether requested strings are appropriate for the registrant. The initial evaluation period will end on November 12, 2012, and applicants failing this phase can request an extended evaluation until November 29, 2012. Approved applicants can then proceed with setting up their newly acquired domain name registries. Due to the complexities of those applications undergoing extended evaluation, ICANN does not have a timeline for completing the extended evaluations.

While ICANN has been vague about the benefits of this new system, merely pointing to the business opportunities it can create, commentators have articulated [various benefits](#). Experts believe this new system can optimize web navigation by creating more memorable domain names and allowing for geographic specificity and that it can reduce phishing scams by legitimizing email addresses and create new business models. Despite these predicted benefits, the new system has also faced criticism. The [Coalition for Responsible Internet Domain Oversight](#) (CRIDO), a joint organization established by the Association of National Advertisers (ANA) and consisting of 102 trade associations and 59 individual companies, fears that cybersquatting and phishing claims may lead to significant legal costs and a burdensome requirement of defensive registrations—essentially forcing companies to spend large amounts to register gTLDs to prevent abuses. Additionally, Esther Dyson, ICANN’s founding chairman, [has suggested](#) that gTLDs will create confusion across the domain name system and increase costs to domain name registrants without actually enhancing value.

ICANN has implemented several mechanisms it believes will prevent cybersquatting and protect against trademark infringement. As such, they are hoping to avoid defensive registrations by applicants who have no intention of actually operating the registry. Experts believe that the high initial costs and extensive application process will [weed out any would-be cybersquatters](#). Additionally, anyone can formally [object to applications](#) [PDF] once they are publicly revealed on May 1, 2012. These objections will be filtered through ICANN’s pre-existing Dispute



Intellectual Property Litigation

FROM THE SECTION OF LITIGATION INTELLECTUAL PROPERTY LITIGATION COMMITTEE

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Resolution Procedures (DRP) and will be administered by independent Dispute Resolution Service Providers (DRSP). Objections can be raised on any of four grounds: confusion with an existing or applied-for gTLD, legal rights infringements, public interest or morality objections, and communal objections against a specifically targeted string. Thus, the onus will be on parties to review these applications to determine whether any infringe the party's intellectual property. Finally, once a new gTLD is launched, the operators must adhere to specified [rights protection mechanisms](#). These rights-protection mechanisms will allow for rapid suspension of domain names in clear-cut cases of infringement and call for the establishment of a trademark clearinghouse—once a party's trademark is verified in this clearinghouse, the party will have a 30-day sunrise period to claim any domain names using or infringing its trademark and subsequently will be notified if anyone attempts to register a domain name with its trademark.

Keywords: litigation, intellectual property, ICANN, gTLD, copyright, infringement, cybersquatting, domain names

—*Stephen Flug of NYU School of Law, Class of 2014*

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